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XXXIX

USURY AND USURY LAWS

USURY AND USURY LAWS

A JURISTIC-ECONOMIC STUDY OF THE EFFECTS OF STATE STATUTORY MAXIMUMS FOR LOAN CHARGES UPON LENDING OPERATIONS IN THE UNITED STATES

BY

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O. M. W. SPRAGUE

SCIENTIST – ECONOMIST

FORMULATOR OF FINANCIAL PRECEPTS

MOULDER OF BUSINESS THOUGHT

WHO TEACHES HIS STUDENTS

TO APPLY

PRAGMATIC TESTS

TO ECONOMIC THEORIES

PREFACE

This series of books owes its existence to the generosity of Messrs. Hart, Schaffner & Marx, of Chicago, who have shown a special interest in trying to draw the attention of American youth to the study of economic and commercial subjects. For this purpose they have delegated to the undersigned committee the task of selecting or approving of topics, making announcements, and awarding prizes annually for those who wish to compete.

For the year 1923 there were offered:

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The present volume, submitted in Class A, was awarded the first prize.

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AUTHOR'S PREFACE

After a period of more than thirty years during which comparatively little was said or written about usury and usury laws, the American business world was startled in the autumn of 1915 by the statement of John Skelton Williams, Comptroller of the Currency at the time, that more than one third of the national banks of the United States had been exacting usurious rates of interest.[1]

Later, as interest rates on all kinds of loans rose to unusual heights during the period just after the World War, California passed a usury law[2] in 1918 to keep them from going higher. The period of high rates for time money in New York[3] in 1920–21 again brought up the question of the expediency of statutes which attempt to fix maximum rates of interest. There arose a conviction among business men all over the United States that such laws are not based upon sound principles of economics.

In June, 1921, during the progress of the Lockwood Committee's investigations of the difficulties encountered by people desirous of erecting dwellings and apartments in New York City, Mr. Samuel Untermyer, in the face of overwhelming evidence that the New York Usury Law was being flagrantly violated by mortgage lenders, shocked the public by declaring that the New York Usury Law ought to be repealed.[4]

[1] See *Wall Street Journal*, *New York Times*, and *Financial America*, of November 29, 1915.

[2] See pages 89–91, below.

[3] Time-money rates went above eight per cent in New York in November, 1920, although the New York Usury Law forbids interest over six per cent. See H. Parker Willis, "Why Money Rates are High," *New York Evening Post*, February 12, 1921.

[4] This investigation disclosed the fact that mortgage lenders were getting from twenty to fifty per cent on real estate loans in New York City by various devices and evasions of the law. See *New York Times*, June 3, 1921.

Because of these and numerous other equally significant events that have been happening in the last seven or eight years drawing the attention of the public mind to the mischievousness and futility of state usury laws, an historical study and an economic interpretation of the general situation in regard to all kinds of interest laws would seem to be now in order.

The problem of usury is not new. Solon and Aristotle had something to say on the subject in ancient Greece. The ancient Hindus had statutory maximums for interest rates. Livy and Tacitus, the Roman historians, touch upon the problem in their writings. Laws dealing with loan charges appear in every period of the history of every commercial nation. The reason that the problem is continually coming up in the United States to perplex legislators is that, at least as far as this nation is concerned, the problem has not been completely solved, although some of the states are on their way to a solution.

At places in this study I have taken issue with certain economic and juristic writers on usury. In this field many problems are still unsettled, and it is only by breaking away in a measure from the past that advancement can be made. Yet no one can discover new truths until he first discerns clearly the old truths. All modern progress has been built upon the progress of the past.

When I began this study in the summer of 1921, I was advised by some of my economist friends that I should get nowhere. I was told that there was no problem; that no usury law could have the slightest effect upon the market rate of interest; that the theory of interest was pretty well perfected and needed no contributions; that all economists were agreed that usury laws are a dead letter and that the laws had gotten on the statute books simply because legislators could not understand the economic principles worked out by Jeremy Bentham in 1787 in his "Letters in Defense of Usury." I was advised that almost any other subject would offer better opportunities. I was told that Bentham

had, in fact, said the "last word" on the subject of Usury.

This advice, although discouraging, led me to search for new factors in the situation and new light on the issues involved. I had a notion that the present-day American usury question might have certain aspects and significant features different from those of the English usury problem of 1787. I found Bentham's "Defense of Usury" to be, as was claimed, an unanswerable polemic against general statutory maximums for all kinds of loan charges, although Irving Fisher, upon the basis of the time-preference theory of interest, proves, in a few paragraphs, the same general proposition that Bentham required several chapters to establish.

There exists, within the bounds of the science of jurisprudence, an inarticulate evolving body of economic thought, apart from but parallel to the systems as developed by the economists. It is to be found in legislative acts and in court dicta and decisions. It should be studied just as it is found, for it loses in freshness and in meaning if we try to dissect it out. Like a precious stone, it appears best and means most in its usual setting. This field of thought might be called "juristic economics." The problem of usury goes into it. Whether society ought to establish statutory maximums for loan charges is much more than a question in the theory of interest. It is a problem touching not only the domain of economic theory, but also the fields of jurisprudence and governmental science. Usury laws exist to-day because the juristic theory of a usury law is sound. If this were not so, the laws would not be on the statute books of forty-three sovereign states. The economist who says that the typical American usury law is merely an evidence of the American legislator's ignorance of economic principles, might well consider whether he has fully grasped the juistic theory upon which a usury law is based.

This essay thus becomes a juristic-economic study. The development of the problem, which is clearly an economic one, has spread out of the field of pure economics into fields not recognized as economic by some economists. Others,

however, will freely accept a broader concept of economics as a science to include what may be called "juristic economics." "Socio-juristic-economics" might perhaps more precisely define the scope of the present inquiry.

Much confusion of thought has prevailed for generations in this country because of two different definitions of usury. Bentham recognized these different definitions, but stated one of them incompletely, and used them both in such a way as to avoid the real issue. First, there is legal usury, which is simply taking more than the law allows. Bentham recognized this sort of usury and defined it correctly. Then there is moral usury, which is taking advantage of the ignorance or necessitous condition of the needy borrower so as to get him into a hard bargain and exact from him unduly high charges. In Germany, where there are no statutory maximums such as our American general usury laws, the two definitions of usury coincide. Moral usury is legal usury there. The Germans and Austrians define usury as "*die Uebervorteilung eines Kreditbedürftiger*," and "*die habsüchtige Ausbeutung der Noth.*" Bentham defined moral usury as the taking of a greater interest than is usual or customary, but this does not tell the whole story.

The keynote of the present inquiry is given by its emphasis upon the distinction between two separate issues, namely, the problem of high market rates of interest on the one hand, and the problem of moral usury on the other. It is generally conceded that general usury laws can accomplish nothing in the way of preventing high rates of pure interest, but in regard to moral usury I find, in the majority of the states, a problem which remains unsolved.

All usury laws in the United States have been enacted by legislatures on the juristic theory that, where the two parties to a loan are in unequal bargaining positions, the state is justified in interposing its police power to correct the situation. Consistently with this theory forty-three state legislatures have enacted usury laws. Moral usury is clearly the evil which such legislation was enacted to eliminate.

This simplifies the task of this inquiry. We know who formulated the usury laws and we know why they were enacted. We know what our legislators have proposed to do, and our problem is to find out how to attain this objective. Fortunately, because of recent developments in legislation, this is not a difficult task. Machinery for the elimination of moral usury is at hand. This machinery is the new Uniform Small-Loan Law with its administrative features. It has been tried out in a few of the industrial states and found very effective.

The present study begins where Bentham left off. It takes up Bentham's argument that no statutory maximum can have any effect upon the market rate of pure interest and finds that it is true, since interest rates fluctuate independently of statutes. It goes back of Bentham to see if he faced all the issues and finds that he did not. It takes Bentham's sweeping proposition about lending money and finds that it was a hasty generalization. It examines Bentham's definitions of terms and finds that he confused them. It recognizes the great importance of Bentham's work, but does not concede that it is the "last word."

In the typical modern textbook on political economy, usury is ordinarily discussed in one or two paragraphs or in a footnote in connection with the theory of interest. This seeming assumption that the problem of usury is merely a phase of the problem of interest is clearly erroneous. Moral usury does not occur in large commercial and investment loans. It typically occurs in consumers' small loans where the loan charge is figured to cover principally overhead expenses and indemnity for losses, and is therefore principally not in the nature of an interest charge.

Some economists have argued that no price-fixing law can operate to interfere with loans, because any kind of loan is simply an exchange of present money for future. This argument is true in cases where there has been no interference with the operation of the economic forces of supply and demand. But the answer to this reasoning is to be found in

the juristic theory of the usury laws already outlined. A statutory maximum becomes economically justified when it operates, not to obstruct or hinder the natural interplay of supply and demand, but when it is necessary to remove things that stand in the way of the formation of fair exchange values or to place the two parties in equal bargaining positions.[1] Moreover, this theory, although an abridgment of the doctrine of Freedom of Contract, is generally recognized as constitutional, since it antedates the Constitution and the Fifth and Fourteenth Amendments out of which have grown the doctrine of Freedom of Contract.[2]

I trust that I shall not be misunderstood. To say that the juristic-economic theory of a general usury law is sound is not at all the same as saying that a general usury law will work. In this essay I have taken great pains to show how and why such laws do not work. But to prove their futility is not enough. Some kind of legal machinery must be built up that will accomplish what the juristic theory of a usury law says it must do. Since Bentham's epoch-making book appeared in 1787, the Anglo-American legal world has been told by economists over and over again with great emphasis that a usury law will not work. But the jurists who have studied into the matter have been equally insistent in declaring with great emphasis that the purpose is commendable and that the theory of a usury law is correct. So we have often had the bewildering spectacle of one state enacting a usury law at the same time that another state was repealing a similar law. The economists have denounced the lawyers and legislators, and the lawyers and legislators have ridiculed the economists. Both were right in one sense, but wrong in another. American legislators built up the old legal machinery of the general usury laws in a sincere attempt to eliminate the evil of moral usury. That the laws

[1] This theory has been accepted as sound economics by many leading economists. See Taussig, *Principles of Economics* (1921), vol. II, ch. 40, § 1.

[2] See pages 141–142, below.

have not worked, that they have done harm, that they are futile and mischievous is no reflection upon the ideals and purposes which inspired their enactment.

The problem of how to eliminate moral usury was finally worked out, not by theorists, but by lawyers and legislators. In a sense this is a triumph of juristic economics over professional economics. It is to the credit of the legal profession that they themselves overcame the difficulties and put the new legal machinery into operation. The new Uniform Small-Loan Law with its administrative features is the mechanism they have devised. Instead of prescribing a general statutory maximum for all kinds of commercial, investment, and consumers' loans, the law operates only in the field of consumers' small loans, where moral usury typically occurs. Instead of merely prescribing severe penalties for exceeding fixed maximums, it supplements the penalties by administrative features which forestall the occurrence of moral usury. The new law "seeks to prevent rather than to cure after the event." It makes justice available to the poor man at the minimum of expense.

If a usury law be defined as a statute that carries out the juristic-economic theory of usury, as developed by the courts, this new law is the first true usury law in the history of the United States. It could be correctly named the "Uniform Usury Law." Although there are certain prejudices which the law would encounter if given such a name, this name might help to increase the popularity of the law.

In this general survey and analysis of the usury problem the issue of the small loan is emphasized for the reason that the immediate problem is in that field. The business world cannot get rid of the detrimental and mischievous old usury laws until the small-loan problem is solved. Moreover, the small-loan problem has a real human interest which an abstract problem can never have. Juristic and economic precepts become more intelligible when related to the actual happenings of life. When one looks into the circumstance of a small loan, it is clear that moral usury and legal usury are

two utterly distinct concepts. It is absurd to brand a man as "usurer" who lends $100 to an industrial worker in distress for a month and charges him $3.50 for the service, when his profit on the transaction after expenses are paid is less than a dollar. Such a lender may very well be a public benefactor. Yet the old usury laws, by their false definition of usury, classify such lenders with criminals.

When legislators have gone into this matter without bias and have carefully and scientifically analyzed the small-loan situation in regard to moral usury, they have been led in most cases to cut off consumers' small loans from the operation of the old six, eight and ten per cent statutory maximums, and to put those small loans under the new law with its much higher rates adjusted to actual costs — in most cases three and one half per cent a month. Where the old laws still govern small loans, necessitous borrowers are still likely to fall into the clutches of the loan sharks operating outside the law and charging rates of from five to ten per cent a month, and even higher.

The small-loans field has become the battleground of this issue, and out of the clash of opinion a clearer conception of the truth is dawning which may be the first step toward a more rational handling of our whole usury problem. Public opinion, hitherto misled by the ancient prejudices concerning usury and confused by the hue and cry raised by false sentimentality, has had time to see the deplorable results of its own zeal in forcing the passage of unsound legislation of which the chief effect has been to prohibit the decent banker-lender from legitimately employing his capital in this field.

On the other hand, those states which have faced the facts and worked out the problem upon a rational basis, and then have set up the new legal machinery with its latest improvements and its loan charge adjusted to the actual expenses and risks of the loan business, have thereby attracted new money into the business, improved its standing, enabled honest capital to be honorably loaned, and elevated the entire situation out of its century-long state of confusion and

discord to its new position of dignity and honor. In these states the old type of lender, branded as "usurer" and "loan shark," has become a legitimate small-loan banker, crooked dealing and moral usury have been exterminated, and the borrowing workingman, instead of being exploited, browbeaten, and hounded down by merciless creditors, is enabled to obtain loans under state supervision and control, at rates which are fair to both parties.

But the evils of our usury legislation will not be entirely remedied by enactment of the Uniform Small-Loan Law. The business world's problem of getting rid of the old usury laws will still persist. These impossible, unreasonable general statutory maximums which can never have any power over the market rate of pure interest, still remain, like dead timber in a forest, to obstruct the progress of business. When interest rates go up as they did in 1920, the banks all have to resort to evasions such as John Skelton Williams discovered. When interest rates fall, the banks "obey" the laws. But the only kind of usury that these banks are guilty of is legal usury, which is not true usury at all. It is very difficult to follow the stretch of the imagination which calls usurious a loan of call money at fifteen per cent on the stock exchange. Nobody of ordinary intelligence would accuse of moral usury the New York commercial banks which in 1920 loaned millions of dollars to merchants and manufacturers at eight per cent. Moral usury cannot develop in the large commercial and investment loans of the financial world.

The present essay divides itself naturally into three parts. In the first division, giving Preliminary Considerations, I have outlined and limited the task undertaken, explained its importance, and defined some of the terms to be used. This section runs into a considerable number of pages because of the difficulties involved in clearing the ground for the main structure of the thesis. It seemed necessary to set forth the usury problem from several angles. It presents different aspects if examined under various conditions, just as a landscape appears quite different according as it is viewed in its

winter setting, its autumn setting, or its summer setting. Chapter II attempts to outline the usury question in its different settings. In the light of economic theory the problem has certain features to be distinguished from the aspects which appear when it is viewed as a problem in legislation. The business man's problem in regard to usury laws is somewhat different from the juristic problem. Yet all are parts of the same fundamental question, and the study would be incomplete if the issue were not presented in all its different phases.

The second division of the study includes an historical approach to the present-day problem of usury. In this section the aim has been to select the bare minimum of historical material necessary for complete analysis. For the reader who desires to go deeper into the history of usury, several valuable books are listed in Appendix A.

While the first division is mainly expository and the second division chiefly historical, the final section of the book is predominantly argumentative. It is in this division that most of my main conclusions are developed. For the busy reader, pressed for time, who desires to survey the book in a couple of hours or less, the best plan will be to read the first two chapters and pages 84–85, and then skip to the chapter of Conclusions. After this the Table of Contents will be of service for finding any particular detailed treatment of subject-matter. Chapter XV will probably be found to be the most interesting and useful part of the book.

It occurs to me that there is a sort of parallel between the work of abstract economics and the work of anatomy. The anatomist can dissect an organ out of a living animal structure and separate it from the living tissues where it normally functions. He can make cross-sections, drawings, and photographs of it for study and analysis. Similarly, the abstract economist can dissect theories out of the economic settings or surroundings in which they were formed and in which they normally function. He can isolate, organize, and classify them. He can do even more with a theory than an

anatomist can do with organic tissues. But after a time, the dissected theory, being intangible, may be changed by transference from mind to mind until there is a danger that it may become a mere abstraction, and, like a physiological specimen preserved in alcohol, lose some of its former importance to the surroundings where it once functioned.

Another phase of this parallel is the similarity between the work of the practicing physician and the work of the practical economist. Just as the physician works with living beings and aims to keep them in good health by warding off ailments and curing functional disorders, so the practical economist or the legislator is a social physician studying and working to prevent and eliminate the ills of the living structure of economic society.

The work of discovering, isolating, and formulating theories is thus distinguished from the work of studying and remedying particular economic situations. But the line between the two kinds of work cannot be sharply drawn, since, in numerous instances, the same economist performs both types of service. The one must have plenty of economic situations from which to organize the data upon which to build generalizations, while the other kind of work requires numerous generalizations built up by abstract theory, to be employed in solving each particular problem.

This inquiry partakes of the natures of both kinds of work, but is predominantly of the latter type. It proceeds to its conclusions working with and studying the functioning living organization of American economic society, and analyzing some of the mechanisms, forces, and interrelations which compose this economic structure. It finds in the American business structure a chronic disorder in which unsound financial legislation obstructs and interferes with the smooth interplay of economic forces and it attempts to discover a remedy. It subjects to critical analysis the materials used in building the thesis, and has at all times rejected things which did not seem to measure up to pragmatic standards.

My answer to this problem of the business world is that there is a way to get rid of these troublesome old usury laws. My message to legislators is that moral usury and loan sharks can be and are being eliminated. My conclusion in regard to the farmers' problem is that far more effective devices than usury laws for reducing rates of interest on farm loans have already been discovered and perfected and are now in use. My criticism of the Benthamite generalization of 1787 is that, after more than a century of usage, it is now in the same predicament in which the theory that the earth is flat found itself when the discovery was made that the earth is a sphere, although the old theory is still true with certain qualifications.

I must make acknowledgment for many valuable suggestions and helps received in the course of the study from Professors T. N. Carver, Roscoe Pound, W. B. Donham, Nathan Isaacs, C. J. Bullock, A. N. Holcombe, E. F. Gay, F. W. Taussig, M. T. Copeland, G. F. Moore, Samuel Williston, Joseph H. Beale, Felix Frankfurter, and W. M. Persons, of Harvard University; from Professors H. P. Willis and R. M. Haig, of Columbia University; and from Professor E. E. Day, of the University of Michigan.

I am especially indebted to Professors H. R. Tosdal, A. A. Young, and O. M. W. Sprague, of Harvard University, under whose directions and supervision this research was carried on.

It is no more than fair to say that I never could have carried out this analysis to its completion if I had not been well grounded in the elementary points of the theory of business law by a set of survey courses under the instruction of Professor W. H. Spencer, of the University of Chicago. I should also add that my method of approaching the issues of the usury problem, as a set of dynamic problems related to the living functioning structure of modern industrial society, was imparted to me by Professor L. C. Marshall, also of the University of Chicago, who was my first teacher in business-economic theory.

I owe a heavy debt of gratitude for many helpful ideas to Mr. Reginald H. Smith, a member of the Boston Bar, whose interest in this subject was first aroused by the abuses that came to his knowledge while general counsel for the Boston Legal Aid Society.

I am deeply appreciative of the valuable help given me in the way of materials and interviews, by a number of business men and jurists of New York, Boston, and other cities.

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FRANKLIN W. RYAN

CAMBRIDGE, MASSACHUSETTS
March 11, 1924

[1] The original draft of this study was submitted in the autumn of 1921 to the Faculty of Harvard University in fulfilment of the requirements of the Jesse Isidor Straus Prize Scholarship of 1921. The essay in final form was entered in the Hart, Schaffner and Marx prize competition of 1923 with the permission of Mr. Straus.

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USURY AND USURY LAWS

* * *

PART ONE

PRELIMINARY CONSIDERATIONS

USURY AND USURY LAWS[1]

PART ONE

PRELIMINARY CONSIDERATIONS

CHAPTER I

THE PROBLEM OF USURY LAWS

THIS study is concerned primarily with the question of the expediency of state laws in the United States which fix general limitations on interest rates, commonly known as the "usury laws." It is, however, difficult to state the whole problem in a single question. What is expedient depends upon the point of view of those interested.

To the abstract theorist it is a problem as to whether usury laws can have any effect on the market rate of interest; to the business man it is a problem of getting rid of the usury laws; and to the legislator it is a problem of finding some means of social control that will prevent the taking advantage by the lender of the necessitous condition and inexperience of the borrower so as to force him into an oppressive contract and extort from him excessive interest charges.

Historically the problem of usury laws was first approached from the point of view of the theorist. From this angle the present problem might be stated as follows:

Is the typical state usury law now expedient, which, when it was enacted, fixed a single general maximum limit for interest rates for all kinds of loans or forbearances of money?

[1] This monograph was submitted as a thesis in 1924 by the author to the Faculty of the Graduate School of Arts and Sciences in Harvard University, in partial fulfilment of the requirements for the degree of Doctor of Philosophy.

This formulation really includes the whole problem, but does not at first sight reveal the different points of view from which the problem must be approached in order to arrive at a complete solution. Although somewhat elusive in meaning, this seems, for historical and other reasons, to be the best way of stating the problem at the outset, and indeed it must be approached first in this way by the necessity of logic.

There is at the present time (1924) a law of the foregoing type in each of the statute books of forty-three states of the United States. Leading business men declare that a usury law serves no useful purpose and that it is an anachronism.

From the purely theoretical standpoint the problem has already been quite well worked out. It is now generally recognized, and has been recognized for half a century by leading economists of America and of the rest of the world, that such laws are powerless to control the market rates of interest and that they are mischievous in their effects. This was pointed out by Turgot in France in 1769, proved in England by Bentham in 1787, and in Massachusetts in 1867 by Richard H. Dana, Jr.

This study will therefore avail itself of the progress already made. It will first review briefly the history of the various steps in economic thought by which such laws were shown to be futile and mischievous and will then take up what appears to be the immediate question in the situation, or rather a somewhat more comprehensive way of stating the problem, which may be formulated thus:

In view of the fact that legislators, in most cases, enacted general statutory maximums for loan charges in order to prevent and eliminate the taking advantage by the lender of the necessitous situation and inexperience of the borrower, to get him into oppressive bargains and extort from him excessive charges, *if such laws are futile and mischievous, how can this original purchase be achieved?*

Probably the best statement of the general business situation out of which this immediate problem arises, was written by Mr. Paul M. Warburg.[1] He says:

Modern banking is built upon gold — and confidence. The basis of confidence is an immutable belief in the continuity of political and social conditions which are held to be safe and sacred. There must be faith in the continuity of the form of government, in the continuity of the legal status, and in the fair observance of law by government and governed alike. There cannot, however, be confidence in the continuity of the laws until they rest on a broad, equitable basis, and are fairly uniform over the entire country.

There is nothing so harmful and dangerous as the existence of two laws, the one a written law, unenforced and often impossible of enforcement, the other a customary law, which stands unchallenged for generations and which the written law cannot override, often because the latter, enacted in haste or hate, is incompatible with reasonable business usages and necessity.

Just and uniform laws, universally observed and equitably enforced, imply wholesome government regulation. Loose or extreme laws that cannot be observed and that, therefore, are not generally enforced, but that may be suddenly and spasmodically enforced according to the whim of the people or of the party in power, yesterday a dead letter and to-morrow a firebrand, imply anarchy and autocracy. . . .

If it had not been possible to pay rates far exceeding six per cent for time loans, it would not have been possible a few weeks ago to draw so much gold from Europe, where money rates were above six per cent, and the catastrophe would have been still worse than it was.

But we venture to ask, why is it necessary to force people to evade the laws in order to carry on business?

The usury laws in Europe, where they exist at all, apply only where the borrower is in dire distress when seeking and accepting a loan, and where the individual or corporate lender knowingly profits from his helpless situation when exacting usurious rates. Usury can be judged only in the light of surrounding circumstances; and usury laws in Europe generally apply only to individuals.

Our law [of New York State] which prevents solvent firms of bankers, merchants, manufacturers, or brokers from contracting for money on time at more than six per cent, implies not only undignified tutelage, but unsound business judgment. The recent

[1] Paul M. Warburg, *Essays on Banking Reform* (1914), p. 47. See also Appendix B for a statement of the situation in England in 1818.

crisis has shown that it was not taking advantage of people in need to give them money on time at over six per cent; on the contrary, it would have been a blessing, and in many cases their salvation, if they had been able to receive the money at even a much higher rate.

Originally it was found that certain evils arose out of the relation of borrower and lender. Early legislators enacted statutes to eliminate these evils, but the evils persisted nevertheless and were even augmented by other evils originating in the statutes themselves. After a time later legislators repealed the statutes and still the first group of evils remained. Then later generations framed new statutory maximums. Thus history reveals to us, at least from the time of the Roman Republic to the present time, for more than two thousand years, a slow and very irregular succession of enactments and repeals of usury laws, a long-drawn-out series of conflicting legislative acts all designed to improve the situation arising out of the borrowing and lending of money.

During the last two centuries the important nations of Europe have one after another repealed their statutes which attempted to fix maximum charges for commercial loans, but in the United States the tendency has been in recent years for such legislation to increase. In 1880 thirteen states had no usury laws. In 1924 there were only five which did not have general usury laws.[1]

The purpose of this study is twofold: first, to examine critically, in the light of generally accepted economic principles, certain typical state laws prescribing maximums for loan charges and designed to prevent the exploitation of necessitous and inexperienced borrowers, to discover wherein some laws have failed and others have succeeded; and, second, to suggest modes of procedure by which the present situation may be improved to the advantage of the borrower, the lender, and the general public.

[1] *Hubbell's Legal Directory* gives annually the provisions of the state usury laws. They are also summarized in *Dun's* and *Bradstreet's* rating books.

The questions involved may be stated as follows:

1. What is the general economic and social-legal situation in which the problem of usury arises?
2. What is the present status of usury laws in the United States?
3. What conclusions can be drawn from a critical study of the arguments already advanced, for and against general statutory maximums for interest rates, of the type of the American usury laws?
4. What improvements in the present situation in the United States are being attempted and what other improvements seem to be indicated from this study?

These questions will be taken up as the study proceeds.

CHAPTER II

THE USURY PROBLEM IN ITS ECONOMIC AND SOCIAL-LEGAL ASPECTS

BEFORE taking up the main questions involved in this study, it seems desirable for purposes of clearness in presentation, to discuss briefly the general economic and social-legal setting in which the problem of usury is located.

THE ECONOMIC SETTING

On the basis of the organization of economic science according to economic activities,[1] the problem of usury at first sight appears to belong primarily in the field of interest or the valuation of the services of capital.[2] The interest problem in its final analysis is a problem in value. But since that which is paid and received as interest is composed of other elements beside pure interest, and includes the approximate reimbursement of overhead expenses incurred by the lender in conducting the business of lending, and an approximate indemnity contribution to a fund for offsetting losses from non-payment of loans, as well as a residual sum as "profits" to the management, the problem extends over the entire field of valuation of services.

There is a marked difference between the making of a large commercial or investment loan and a small loan to an industrial worker. In instances of the former type, such as when a bank lends $500,000 to a large cotton mill for working capital, or when a railroad company borrows $1,000,000 to buy equipment, the capital is borrowed to use

[1] T. N. Carver, *Distribution of Wealth*, p. xiii.

[2] For studies of the services of capital see: Alfred Marshall, *Principles of Economics* (8th ed.), book VI, ch. VI; T. N. Carver, *Principles of National Economy* (1921), ch. 38; F. W. Taussig, *Principles of Economics* (1921), vol. II, ch. 38.

in further production, whereas in the latter case the wage-earner typically uses his borrowed money to buy necessaries of life for some personal or family emergency. The former is called a productive loan and the latter a consumer's or consumptive loan. In productive loans the loan charge is principally pure interest; in consumptive loans it is principally not interest. One of the reasons why the problem of usury has not been solved in the past is because the other elements in a loan charge besides pure interest were not clearly recognized and understood.

There are no cases where a loan charge contains nothing but pure interest, but it can be estimated by studying such loans as those made to the United States Government, where all risks and other elements are reduced to the minimum. Interest is the market price for the use of capital in production. It is, like any other price, the equilibrium resultant of the forces of demand and supply. Moreover, the particular forces of demand and supply which operate to form the rate of interest[1] are enormously powerful, both being measured in billions of dollars. A state usury law has about as much effect in limiting these forces, which are the cause of interest, as a similar law would have in attempting to limit or control the tides of the ocean.

The problem of usury is not a problem of pure interest. Pure interest remains at the same level in any one money market at any particular time, regardless of the extent of any individual loan charge. That part of a loan charge which causes it to be regarded as "usurious" is never interest at all. Consequently, since the rate of loan charges in productive loans contains these other elements which are not interest in relatively small amounts, this study will give a larger share of attention to consumers' small loans.

Mr. Frank H. Pope, Supervisor of Loan Agencies for the State of Massachusetts, summarizes the industrial borrowers' situation in the commonwealth as follows:[2]

[1] The equilibrium law of interest is stated on pp. 70–73 below.

[2] From a letter written to the author dated March 5, 1924.

In 1923 the licensed money-lenders of this commonwealth made loans amounting to $7,451,357.03, each loan representing a $300 transaction or less. Practically all of the money lending agencies in this state, aside from the Morris Plan companies and three or four other companies who discount their loans and loan upon joint notes, loan on chattel mortgages. . . .

I believe improvidence is the real reason. There are very many persons who have not been inculcated with the idea of thrift. They live virtually from day to day, trust a good deal to luck, want to keep up the pace of more prosperous neighbors and associates, and then, when the pinch comes, arising from death, sickness, or many other causes, they have no recourse, if money is desired, except to visit the money-lender.

Because of the fact that the borrower is usually in a weak bargaining position when seeking such a loan, and because it is so easy for a lender to take advantage of his ignorance and necessity to extort from him unduly high charges, nearly all nations have set up legal machinery for regulation of loan charges. The usury laws, which are general statutory maximums, were enacted in ignorance of the economic laws of interest and without taking the trouble to study lenders' costs.

The Social-Legal Setting of the Problem

The lending of money has in all periods of history been influenced and regulated by such forces and agencies of social control over business as public opinion, custom, common law, statutory enactments, and the supervisory agencies of governments. From the very beginnings of commerce, social control has been manifest in the formulation of rules for the paying and receiving of interest.

Not all interest laws are usury laws. But most of them prescribe rules which society has made for the purpose of eliminating what were considered to be evils.

It will be helpful to consider the social purpose back of some of the different kinds of interest laws. Certain laws have been enacted for the convenience of courts, such as those fixing the statutory rate of interest to apply where

a court renders judgment for money due with interest. Others have been enacted to protect merchants — as, for instance, in the case of laws prescribing the statutory rate of interest collectible on overdue accounts where the parties have not stipulated a rate. Such laws are necessary also to protect the merchant's customers.

The law stipulating a "legal rate" of interest is also of service in protecting lenders and payees of promissory notes. This law designates the statutory rate of interest to apply on loans and forbearances of money where the parties have not named a rate.

Certain laws have been devised to facilitate commercial transactions where interest-bearing instruments are used. It may be said that all the rules of commercial law were made to facilitate transactions and give certainty to business men about to enter into contracts. The Negotiable Instruments Law provides that innocent holders for value without notice shall be protected even from the provisions of usury laws. But in some states — as, for instance, Arkansas — a negotiable instrument once tainted with usury is void even in the hands of an innocent holder for value without notice. Another provision which gives certainty to commercial transactions tells when interest shall begin to run on a note even if not stipulated.

Usury in the United States is the taking of a greater interest than the law allows. Several reasons have been given for the passage of a law setting a statutory maximum for interest rates. Adam Smith wrote [1] of the value of such a law in repressing the activities of "projectors" or, as we call them to-day, promoters. There are, however, for all practical purposes, but two social motives which have brought about the passage of statutory maximums for interest rates, namely, a desire to prevent the lender from making oppressive bargains with the borrower by taking advantage of his necessity and inexperience, and the desire to "fix the price" of money for the benefit of society in

[1] See p. 55 below.

general. The Statute of Henry VIII (1545), which fixed a maximum of ten per cent for interest rates, was enacted at the same time with a number of other sumptuary laws intended to regulate the prices of the necessaries of life.

The desire to protect the borrower from oppressive bargains has, however, been the chief motive back of statutory maximums for interest rates in the United States. But, paradoxical as it may seem, this same motive has been the cause of the repeal of similar limitations on interest rates in many foreign countries where such maximums have been shown to be futile and mischievous. It has been the motive, for similar reasons, for the recent enactments in many of our states, of special statutory maximums for interest rates on consumptive loans popularly known as "small-loan laws."

In most foreign countries, however, it has been found that unfair lending practices can generally be prevented by means of non-price-fixing laws which do not attempt to prescribe rate maximums, but which strike directly at the evils to be eliminated. Germany has a law enacted in 1880 and amended in 1893 which makes it a criminal offense to obtain a profit by taking advantage of the necessitous condition of the borrower, or of his inexperience in reference to loans or other transactions, and exacting a rate "exceeding the usual rate in such a way that the profit seems out of proportion to the service rendered." The law makes transactions of this nature null and void.[1] The English Money-Lenders' Act of 1900 and the Usurious Loans Act of India (1918) are typical of another kind of non-price-fixing law by which the court can remake the loan contract if it finds that the interest charge is excessive or if the transaction is unfair or oppressive.

Interest laws may be classified according to several different schemes. On page 13 is shown a classification according to social purposes, and on page 15 according to legal characteristics. One classification in a measure supple-

[1] Palgrave, *Dictionary of Political Economy*, vol. II, p. 434.

INTEREST LAWS CLASSIFIED AS TO SOCIAL PURPOSE

Interest Laws.

1. **Laws for the Convenience of the Courts.** — Statutory rate of interest to apply where a court renders judgment for money due with interest.

2. **Laws to Protect Merchants.** — Statutory rate of interest collectible on overdue accounts where the parties have not stipulated a rate.

3. **Laws to Protect Lenders and Payees of Promissory Notes.** — Statutory rate of interest to apply on loans and forbearances where the parties have not stipulated a rate.

4. **Laws to Facilitate Commercial Transactions where Interest-Bearing Instruments are Used.**
   - A. **Rule to Protect Innocent Holders for Value without Notice.** — Provision in the Negotiable Instruments Law.
   - B. **Rule as to when Interest shall Begin to Run when not Stipulated.** — Provision in the Negotiable Instruments Law.
   - C. **Other Rules of Commercial Law.**

5. **Laws to "Fix the Price of Money."** — Statutory Maximums for Loan Charges

6. **Laws to Prevent the Lender from Making Oppressive Bargains with the Needy or Inexperienced Borrower.**
   - A. **Statutory Maximums for Loan Charges.**
   - B. **Non-Price-Fixing Usury Laws.**

7. **Laws to Rectify Defects in Existing Laws.** — (Example: In New York, corporations cannot plead usury, and call loans are not subject to the usury laws.)

ments and corrects the defects of the other, but it should not be inferred that interest laws can, under any scheme of presentation, be completely dissected out of the great body of commercial law.

The second classification is valuable chiefly because it shows the location of the American usury laws and small loan laws in their relation to other interest laws of both the United States and other commercial countries. It blocks out the territory which this monograph will cover and shows the distinct types of laws which society has found useful in exercising control over the paying and receiving of loan charges.

In the United States, as has been noted, the prevalent definition of usury is the legal one which conceives it to be the taking of a greater rate of loan charge than the law allows. But the original and ultimate definition of usury is the moral one which conceives it to be the exacting of a greater interest than is reasonable at the time, by taking advantage of the necessitous condition or inexperience of the borrower. Legal usury is not necessarily in all cases unsocial, but moral usury is always condemned by public opinion as unsocial. This condemnation is clearly indicated by such opprobrious epithets as "loan shark," "usurer," and "bleeding the wage-earner," all of which imply exploitation.

This brings out a very important point which will be further commented upon later. It is that, under the operation of the American system of statutory maximums for preventing usury, the issue of moral usury can never arise in a lawsuit. In other countries, under the operation of non-price-fixing usury laws, when a usury case comes up for trial, the court must first determine whether there has been moral usury before taking action.

This difference between the two definitions of usury is not unknown to the American courts. There are many decisions which seem to have had this distinction in mind. In such decisions the courts show an inarticulate hostility to the legal definition of usury.

INTEREST LAWS CLASSIFIED ACCORDING TO LEGAL CHARACTERISTICS

INTEREST LAWS.

- **I. "LEGAL RATE."[1]** (Both a maximum and a minimum.)
  1. Rate of interest to apply where a court renders judgment for money due with interest.
  2. Rate of interest to apply where parties to a loan with interest have not specified the rate.
  3. Rate of interest collectible on overdue accounts where the parties have not specified the rate.
  4. Other provisions.[2]
- **II. STATUTORY MAXIMUMS.**
  - 1. GENERAL STATUTORY MAXIMUMS.
    - a. Ancient and Medieval Usury Laws. (Maximums generally from zero to ten per cent.)[3]
    - b. AMERICAN USURY LAWS. (Maximums ordinarily from six to twelve per cent.)[4]
  - 2. SPECIAL STATUTORY MAXIMUMS.
    - a. SMALL-LOAN LAWS.[5] (Maximums ordinarily from thirty to sixty per cent.)[6]
    - b. Pawnbroking Laws.
    - c. Other special maximums.
- **III. NON-PRICE-FIXING USURY LAWS.**
  - 1. COMMON-LAW RULES. ("Equity will prevent the enforcement of any oppressive bargain." (English rule 1854 to 1900.)[6]
  - 2. LAWS BY WHICH MORAL USURY VOIDS THE CONTRACT.
    - a. Laws applying generally to all types of loans.[7]
    - b. Laws applying only to consumptive loans by small lenders.
  - 3. LAWS BY WHICH THE COURT CAN REMAKE THE CONTRACT IF THERE IS MORAL USURY.
    - a. Laws applying generally to all types of loans.[8]
    - b. Laws applying only to consumptive loans by small lenders.[9]
- **IV. ENACTMENTS OF EXCEPTIONS WHERE A STATUTE DOES NOT APPLY.** (Such enactments in many states are gradually diminishing the scope of the usury laws.)
- **V. PROVISIONS OF THE NEGOTIABLE INSTRUMENTS LAW.** Ordinarily no interest law can be passed which would tend to derogate from the rights of a *bona-fide* holder or assignee for value without notice.[10]

[1] Most foreign nations and all American states have a "legal rate."

[2] See Idaho law, Appendix E.

[3] There is no great difference between a law fixing a maximum of zero and one fixing a maximum of six per cent.

[4] Rhode Island's maximum is 60 per cent.

[5] See provisions of Small-Loan Laws in Appendix I.

[6] Stuart, V. C., in Barrett *v.* Hartley, 1886, L.R. 2 Eq. 795; James *v.* Kerr, 1889, 40 Ch.D. 449.

[7] A typical law of this kind is the German law of 1880 amended in 1893.

[8] A typical law of this kind is the Usurious Loans Act of India, 1918.

[9] A typical law of this kind is the English Money-Lenders' Act of 1900.

[10] Usury is an absolute defense in some states, where negotiable paper tainted with usury is void even in the hands of an innocent holder for value without notice.

Usury is an equitable or personal defense in most of the other states, but not in Maine, Massachusetts (with exceptions), Colorado, New Hampshire, and Nevada. See Appendix E.

It is reasonable to think that if a judge, familiar with the true social purpose of a usury law, and thoroughly conversant with the economic laws of interest, clearly perceived this difference between the legal definition of usury and the moral definition, and was convinced that there could be no moral usury in a contract which stipulated a loan charge of eight per cent when the statutory maximum was six or seven per cent, he would do everything possible to render a just decision if he could find some way to get around the law.

That numerous court decisions have been made with this distinction between moral and legal usury, at least inarticulately in mind, is shown by the unconscious hostility of courts toward legal usury in abandoning the doctrine of *lex loci contractus*[1] in cases where loan contracts made in one state are to be performed in another state. On this point Professor J. H. Beale says:[2]

> The courts, whether from love of commerce or from hatred of usury laws, have upheld contracts wherever it was possible against the defense of usury. They have generally upheld the contract if it was valid either at the place of making or the place of performance, upon the theory that the parties chose to be governed by that law which gave validity to their acts.

A similar tendency on the part of the courts can be seen in cases of loans stipulating higher interest than the lawful rate, alleged to be repayable only upon a contingency.[3] Where courts have held such contracts valid, there seemed to be certainty that moral usury was not present. If a court were certain that such a contract were morally usu-

[1] The doctrine that the law of the place of making the contract governs performance.

[2] Joseph H. Beale, *Cases on Conflicts of Laws* (3 vol. Edition, 1902), vol. III, Summary, p. 542, § 91. See also Wm. R. Vance in *Cyclopedia of Law and Procedure*, vol. 39, p. 891. The following cases serve to illustrate the point: Bigelow *v.* Burnham, 83 Iowa, 120; Ashhurst *v.* Ashhurst, 119 Ala. 219, 20 So. 760; Lanier *v.* Union Mtg. Co., 64 Ark. 39, 40 S.W. 466; Smith *v.* Parsons, 55 Minn. 520, 57 N.W. 311; Kellog *v.* Miller, 13 Fed. 198, 2 McCrary, 395.

[3] See pp. 23–24 below.

rious, plenty of precedents could be found for declaring it legally usurious.

A dislike of legal usury on the part of courts is to be found also in the construction of contracts as to usury. If two reasonable constructions are possible, by one of which the contract will be legal and valid while by the other it will be usurious and invalid, the court will always adopt the former.[1] The general rule of interpretation and construction of such contracts may be said to be that the contract is not usurious when it may be explained on any other hypothesis.[2]

Again in equity cases[3] there seem to be grounds for a belief that some courts have had in mind, as an ultimate criterion, the true or moral definition of usury rather than the legal one.[4]

In summary, it seems clear that the difference between moral and legal usury has been frequently considered and indirectly acted upon by the courts in the following ways:

1. By setting forth the theory and social purpose upon which a usury law proceeds, which are simply to prevent moral usury.
2. By throwing out legal usury where laws conflict.
3. By considering the substance of the contract, and ruling that certain loans alleged to be repayable only upon contingencies, were valid or invalid regardless of the form of the transaction.
4. By disregarding usury laws in the construction of contracts.
5. By the decrees of courts of equity in regard to usurious contracts.

[1] Wm. R. Vance, in *Cyclopedia of Law and Procedure*, vol. 39, p. 917.
[2] *Ibid.* See cases cited on p. 917, footnotes 53 and 54.
[3] See p. 24 below.
[4] See p. 15, footnote 6, for cases showing the historical development of rules of equity in regard to usury.

Limitations of the Problem

From the foregoing brief survey of the problem of the American usury laws in some of its various aspects, it now can be seen that this study is to cover only a limited part of the wide field of interest laws. It is concerned with the expediency of general statutory maximums for loan charges as contemplated in the typical state usury laws and with the problem of special statutory maximums such as are prescribed in our small-loan laws, since both of these types of laws propose a solution of the problem of moral usury.

The study will not deal particularly with the penalties prescribed for violating usury laws, since these vary widely from state to state and are subject to court interpretations. The discussion may fairly proceed on the assumption that prescribed penalties are sufficiently severe and are all designed to make the laws observed and respected.

There will be no occasion for a detailed recital of the history or of the provisions of usury laws in foreign countries except in so far as may be necessary to show the origin of American statutes, or to trace the development of economic thought on the subject, or to find a way to eliminate the evils connected with the borrowing and lending of money.

Federal Reserve Bank Discount Rates in Relation to Usury Laws

It is well to point out that no direct control of Federal Reserve Bank discount rates can be effected by state usury laws. Except for Section 5197 of the United States Revised Statutes, the state legislatures would not be able to control, in any way, the rate of interest to be contracted for by national banks. This section refers to national banking associations only; that is, to banks created under the National Banking Act. Federal Reserve Banks are not national banks within the meaning of this legal provision.

Furthermore, the rediscount of a note at a Federal Reserve Bank is in essence a sale of property with agreement to repurchase. A long line of court decisions and numerous statutory enactments [1] have established the principle that a rediscount is a sale of property, and is not subject to any statutory provision governing the contract rate of interest.[2] It has long been well settled that note-brokers and commercial-paper houses may legally sell their paper (rediscount it) at whatever rate they can get. The *bona-fide* sale of a note at a discount, however large, is not a usurious transaction.[3] Loans of money with excessive interest are plainly to be distinguished from amounts paid for securities and instruments which are transferred in the usual course of business by endorsement.[4]

Should Congress ever enact a law limiting the rate of discount of the Federal Reserve Banks, serious consequences might be expected. The Federal Reserve System would then be in a situation similar to that of the Bank of England in the period 1796 to 1820, during which the bank was compelled to suspend specie payments. The statutory maximum of the English usury law at that time was five per cent and there was no way by which the bank could evade it. This was a serious obstacle [5] to the efficient control of credit.[6] It also interfered with the full use of the bank rate as a corrective of unfavorable foreign exchange situations. In 1793 during the period of crisis the bank met the situation by restricting credit. It refused to lend. This action

[1] See statutory provisions in Appendix E, p. 205.

[2] See Wm. R. Vance, *Cyclopedia of Law and Procedure*, vol. 39, p. 926. "It is manifest that any person owning property may sell it at such price and on such terms as to time and mode of payment as he may see fit and such a sale if *bona fide* cannot be usurious, however unconscionable it may be."

[3] Brannan, J. D., *Negotiable Instruments Law* (Cincinnati, 1920), sec. 66.

[4] Daniels, J. W., *Negotiable Instruments* (1913), sec. 768.

[5] H. D. MacLeod, *Theory and Practice of Banking* (London, 1902), vol. II, p. 347.

[6] Andreádès, *A History of the Bank of England* (London, 1909), p. 260.

threatened ruin to many solvent business concerns.[1] The Government then intervened and obtained statutory powers to make advances to merchants by means of exchequer bills. Cash advances were not made. The only way the Government could have made cash advances would have been by first obtaining the cash from the Bank of England.[2] This five per cent maximum remained to obstruct the operations of the bank until 1833, when the bank was exempted from the action of the usury laws so far as the discount of bills not having three months to run.[3] The disadvantages of legally limiting the rate of discount were experienced in France also.[4] In that country it was found necessary in 1857 to enact a special law authorizing the Bank of France to raise its rate above six per cent.[5]

During the period of high money rates in 1919–20 the New York Federal Reserve Bank raised its rediscount rate as high as seven per cent,[6] although the maximum set by the New York State Usury Law is six per cent. This action of the bank, as has been explained, was not illegal even though the New York statute is one of the severest of the American usury laws. If the Federal Reserve System were subject to the state usury laws, it would be powerless to control the economic situation in times of threatened credit inflation.[7]

[1] H. D. MacLeod, *Theory and Practice of Banking*, vol. I, p. 521.

[2] Hawtrey, R. G., *Currency and Credit* (London, 1923), pp. 262–63.

[3] Andreádès, *A History of the Bank of England*, p. 261.

[4] Cauwes, *Cours d'Economie Politique* (3d. Ed.) Paris, 1893, vol. II, p. 322.

[5] See pp. 51 and 57 for later changes in usury laws.

[6] *Federal Reserve Bulletins* of 1919, 1920.

[7] During this period the Philadelphia Federal Reserve Bank did not raise its rediscount rate above the six per cent maximum set by the Pennsylvania usury law. Some economists have thought that in this case the usury law indirectly interfered with the Federal Reserve rediscounting policies. The bank could have lawfully raised its rate above the six per cent maximum, but there was considerable opposition among the member banks to such action. It is my opinion that if the Pennsylvania usury law had not been in force to interfere with the operations of these member banks, there would have been less opposition to the increase in the discount rate. But this raises a question of Federal Reserve policy and is not directly a problem of statutory control.

CHAPTER III

THE PRESENT STATUS OF USURY LAWS IN THE UNITED STATES

In every state of the United States there has been established by statute a basic rate of interest on loans, known as the "legal rate," which applies to certain contracts where the parties have not agreed upon any rate. This so-called "legal rate" varies from five per cent per annum in Louisiana, Michigan, and Illinois to as high as eight per cent in some of the southern and western states.

In addition to such provisions establishing legal rates of interest, most of the states have established also maximum rates for interest on loans above which the rate of interest is unlawful. This latter provision constitutes the typical state usury law in the United States. In some of the states the "legal rate" and the maximum lawful limit are the same; in others there is a margin of several points between the two. This maximum limit varies from six per cent in a large group of eastern states to as high as twelve per cent in some of the far western states. Rhode Island has a maximum limit of thirty per cent, and is the only state with a general limit higher than twelve per cent.

A usury law is generally understood to be a statute fixing a maximum rate of interest for loans or forbearances of money and enacted with no intent to differentiate between cases where interest is to be collected, either as to types of loans, kinds of security, administrative costs, or magnitude of risks involved.

In recent years some of the state legislatures, recognizing differences as to risks, types of loans, costs, and security, have exempted consumptive loans from control by the usury laws, and have enacted new statutes fixing special maximums for loan charges on such loans, ranging typically

from thirty to forty-two per cent, but in some instances as high as sixty per cent. These special laws have, however, never been called usury laws. They are generally known as "small-loan laws" [1] and will be thus referred to in this monograph. In some cases the small-loan laws are intended to govern pawnbroking, while in other cases they do not. Many states have special pawnbroking laws prescribing maximum rates of loan charges which are quite different from either the usury laws or the small-loan laws.[2]

The elements which must concur in order to constitute usury have been stated as follows: [3]

> To constitute usury in contemplation of law the following essential elements must be present: (1) There must be a loan or forbearance; (2) the loan must be of money or something circulating as money; (3) it must be repayable absolutely and at all events; (4) something must be exacted for the use of the money in excess of and in addition to the interest allowed by law.

It is generally accepted that at common law there was no limit to fairly made charges for the use of money agreed upon by the parties to the loan.[4] The illegality of usury is wholly the creation of legislation.[5]

The theory of a usury law is that the borrower's necessities deprive him of freedom in contracting and place him at the mercy of the lender.[6] Usurious transactions, due to the actual or present disparity of conditions between the parties, have formed an exception to the general rule, that parties shall be deemed *in pari delicto* when they intentionally participate in the violation of the law.[7] The borrower is supposed to be under such moral duress as to take from him the character of *particeps criminis*.[8]

[1] See Appendix I, pp. 230–231, for a digest of the small-loan laws of the United States.

[2] See Appendix K, p. 241.

[3] Samuel Williston, *Law of Contracts*, p. 2962. He quotes from Clemens *v.* Crane, 234 Ill. 215, 229; 84 N.E. 884.

[4] J. A. Webb, *Law of Usury*, p. 3. [5] 77 Cal. 548; 20 Pac. Rep. 77.

[6] Frorer *v.* People, 141 Ill. 171; 13 N.E. Rep. 395. See p. 77n below.

[7] J. A. Webb, *Law of Usury*, p. 15.

[8] Hewitt *v.* Dement, 57 Ill. 500; Fellows *v.* Longyor, 91 N.Y. 324; Schermerhorn *v.* Talaman, 14 N.Y. 93.

It is held, therefore, that usury laws are for the protection of the borrower only who is regarded as the victim of oppression, and a contract tainted with usury can ordinarily be complained of or defended against only by him or his representatives.[1] The lender is not allowed to take advantage of the statute because he is the guilty party.[2]

Avoiding the Usury Laws by Making Loans not Repayable at all Events

It is not usury to advance money which is to be repayable only on a contingency, even though the sum that will be repaid if the contingency happens exceeds the amount loaned with lawful interest.[3]

In states that have not legalized and regulated the small-loans business and where the only legal rate is practically the bank interest rate, a good many loan offices use a conditional obligation in which the principal sum is not repayable at all events.[4] The debtor is forgiven the debt upon the happening of any one of a set of contingencies which typically includes death, disability, or continued unemployment of the debtor as well as the loss or destruction of household goods mortgaged as security for the loan. By a long line of cases such loan contracts have been held to be not usurious.[5] On the other hand, a mere colorable hazard will not prevent excessive loan charges from being usurious.[6] In the case of Missouri, Kansas & Texas Trust Company *v.* Machlin,[7] it was found by the court that

[1] Ford *v.* Hancock, 36 Ark. 248.

[2] Ferguson *v.* Sutphen, 8 Ill. 347.

[3] Samuel Williston, *Law of Contracts*, vol. III, § 1692. Also see Wm. R. Vance in *Cyclopedia of Law and Procedure*, vol. 39, p. 944.

[4] From a letter to the author from the Legal Reform Bureau, 135 Broadway, New York City, dated March 4, 1924.

[5] Some of the cases are: Pomeroy *v.* Ainsworth, 22 Barb. (N.Y.) 118; Clemens *v.* Crane, 234 Ill. 215; Colton *v.* Dunham, 2 Paige (N.Y.) 118; Ordway *v.* Price, 194 N.W. 321; Boone *v.* Andrews, 30 Ohio Cir. Ct. 166; Waite *v.* Windham C. M. Co., 37 Vt. 608.

[6] Missouri, etc., Trust Co. *v.* Krumseig, 172 U.S. 351, 357.

[7] 59 Minn. 468.

the promise in the contract to make the loan repayable only upon a contingency, to wit, the continuance of the life of the debtor, was merely a contrivance to cover usury. In states having the Uniform Small-Loan Law, risks of loss because of death, disability, unemployment and loss of security are already partly covered in the three and one-half per cent monthly loan charge. Such a contract, if used to get a higher charge than this, would probably be declared usurious in some states. The question in each case is whether the agreement be fair and reasonable or a mere device to evade the usury statutes.[1] There are other devices[2] for getting around the usury laws, but the courts generally will not allow them to be used as cloaks for usury.[3]

Equity and Usury

Whenever the statutes have made usurious loans and obligations absolutely void, if a borrower brings a suit in equity for the purpose of securing a usurious security or having it surrendered up and canceled, the relief will be granted only upon condition that the plaintiff himself does equity by repaying to his creditor what is justly and in good faith due, that is, the amount actually advanced, with lawful interest; unless, indeed, the statute has gone so far as expressly to prohibit the court from imposing such terms as the price of its relief. The same principle has been applied to a lender seeking the aid of the court to reform a security tainted with usury. Ordinarily he must produce the note or instrument and rebate the usurious interest. But when a lender sues in equity to enforce a usurious

[1] Samuel Williston, *Law of Contracts*, vol. III, § 1692, n. 57.

[2] *Ibid.*, §§ 1692–96.

[3] Some courts have held, where the compensation for the use of money does not exceed the lawful rate until a future date and where the debtor is penalized by a higher rate for failure to pay at maturity, that the excessive interest does not constitute usury. (39 *Cyc.* 954; Walker *v.* Abt, 83 Ill. 226; Downey *v.* Beach, 78 Ill. 53.) But similar charges were found to be usurious in Seeke *v.* Norman, 78 Iowa, 254, and Conrad *v.* Gibbon, 29 Iowa, 120.

obligation, the borrower may set up the defense and defeat the suit. He who comes into a court of equity must come with clean hands.[1]

There were, in 1921, five states, Massachusetts,[2] Maine, Nevada, New Hampshire, and Colorado, in which there were no maximum limits for interest rates on the ordinary large commercial and investment loans for productive purposes where the borrower expects to make a profit out of the use of the loaned capital. But none of these states, nor any of the other states, is without a statutory maximum for charges on small loans made for consumptive purposes.

The American colonies, from the period of their first establishment, recognized the jurisprudence and common law of England. They also adopted and used the great body of English statutes, including the English rules in regard to usury. The Statute of Anne (1713), which fixed a maximum rate of interest of five per cent for all loans, was the model followed. This statute remained in force in England for a period of one hundred and forty years.

The table on page 27 gives the chief provisions of the early usury laws in the American colonies.

On pages 28–31 is given a tabular summary of the chief provisions of the interest and usury laws in effect in the United States in 1921.[3] Several interesting points may be

[1] Pomeroy, *Equity Jurisprudence*, vol. 1, § 391.

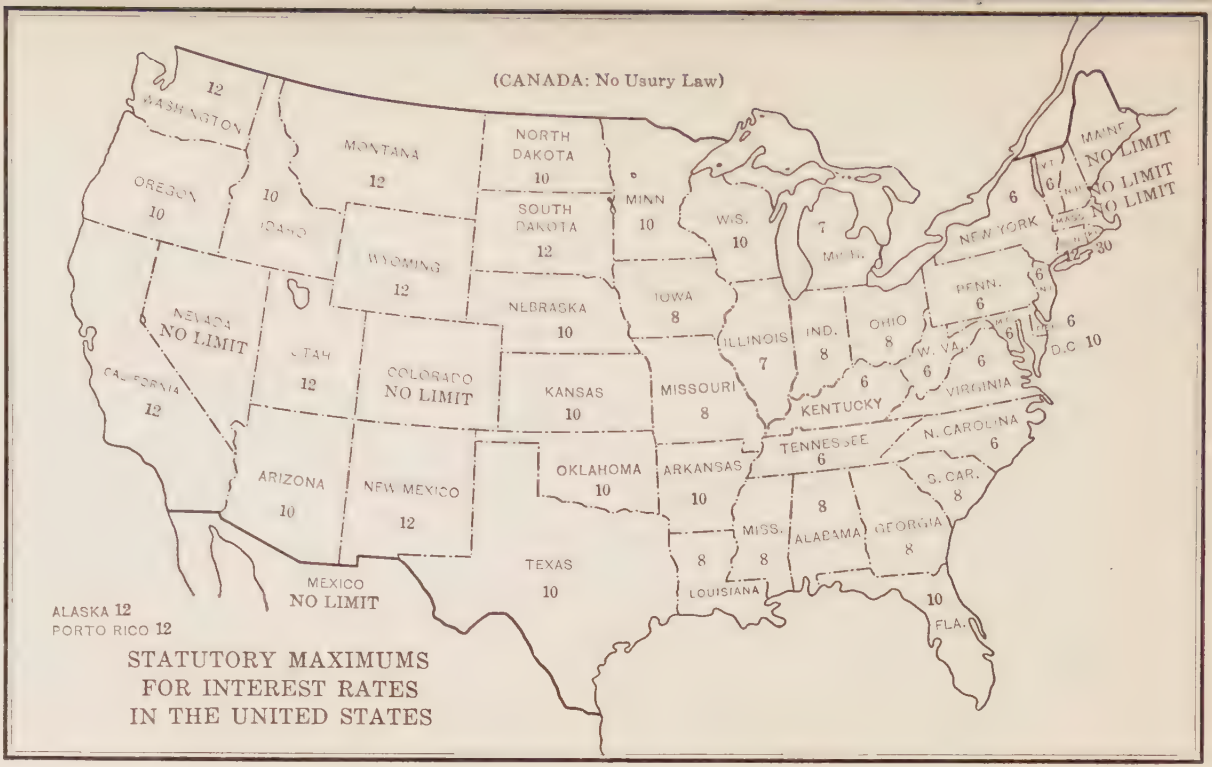
[2] In Massachusetts there is no penalty for usury on ordinary loans except on loans of less than $1000. Massachusetts has a small-loan law for loans below $300.

[3] Chapter III and Appendix E were written as of 1921 because all the data in Chapter XII and Chapter XIII on actual rates charged in the United States are of 1921 or earlier. There are no later figures available on actual loan charges. The chief value in studying usury laws in this connection is to compare the statutory maximums for a given period with actual loan charges during that period in which the laws are in force. Changes are continually taking place in the usury laws. To ascertain what are the actual provisions to-day would necessitate a study of the records of the state legislatures and of the various state Revised Statutes. To make the abstracts and tables in this thesis conform approximately with present-day laws, a few minor changes should be made.

noted in comparing these present-day laws with the early colonial provisions. (See Plate I.)

In colonial times there was no margin between the legal rate and the lawful maximum, both being identical. To-day there is a group of ten states (in 1921 eleven states), all forming one compact area, in which the legal rate and the lawful maximum are both six per cent. Outside of these states, margins are allowed above the so-called legal rate.

In the colonial period the statutory penalty for usury was generally much more severe than now. It was a forfeiture of the contract in all the laws before 1767 and of two or three times the principal in some of the southern colonies. At present only three states, New York, Arkansas, and Oregon, provide for forfeiture of the principal in case of usury. Some of the states now provide for a forfeiture of double the amount of interest. Some states make usury a misdemeanor. In most jurisdictions, however, the statutory penalty is merely a forfeiture of all or part of the interest or some milder penalty.



STATUTORY MAXIMUMS
FOR INTEREST RATES
IN THE UNITED STATES

EARLY USURY LAWS IN THE AMERICAN COLONIES[1]

Name of Colony	Date of Statute	Legal Rate and Maximum Limit	Penalty for Usury
Connecticut....	1718	6	Voidance of contract.
Delaware.....	1759	6	Forfeiture of whole debt.
Georgia.....	1759	8	Forfeiture of thrice the amount of the contract.
Maryland.....	1692	6	Forfeiture of treble the principal.
Massachusetts..	1661 1693	8 6	Voidance of contract.
New Hampshire	1791	6	Forfeiture of three times the excess of interest.
New Jersey....	1738	7	Forfeiture of contract.
New York.....	1717 1718 1737	6 8 7	Forfeiture of contract.
North Carolina.	1741	6	Voidance of contract and forfeiture of twice the amount of the contract.
Pennsylvania...	.. 1700 1705 1723	8 6 8 6	Forfeiture of contract.
Rhode Island...	1767	6	Forfeiture of the excess of interest.
South Carolina.	1719 1748 1777	10 8 7	Forfeiture of three times the principal.
Virginia.....	1730 1734	6 5	

[1] In cases where the date of founding of the colony is prior to the date of the statute, the English law of that period was followed.

In colonial times there was no margin between the legal rate and the lawful maximum. In some of the colonies, such, for instance, as Maryland, a higher rate of eight per cent was permitted for a loan of tobacco, wares, etc., to be repaid in kind.

The data for this table were taken from J. B. C. Murray, *History of Usury* (1866), ch. IV.

THE CHIEF PROVISIONS OF THE STATE INTEREST LAWS[1] OF THE UNITED STATES, 1921

Name of State	Legal Rate	Lawful Limit	Penalty for Usury[2]
Alabama	8	8	Forfeiture of all interest and costs.
Alaska	8	12	Forfeiture of double the amount of usurious interest.
Arizona	6	10	Forfeiture of all interest.
Arkansas	6	10	Forfeiture of principal and interest. Negotiable paper tainted with usury is void in the hands of an innocent holder.
California	7	12	Forfeiture of three times the excess. Imprisonment and fine for evasions.
Colorado	8	no limit	No penalty.
Connecticut	6	12	No action shall be brought to collect either principal or interest.
Delaware	6	6	Contract is vitiated, and any one may sue usurer for amount equal to sum loaned.
District of Columbia	6	10	Forfeiture of all interest.
Florida	8	10	Forfeiture of all interest.
Georgia	7	8	Forfeiture of entire interest.

[1] The data for this table were taken from the Revised Statutes of the various states as found in the Harvard Law Library. In many cases where the statutes were not as late as 1921, reference was made to "Interest Rates in Different States," in *Journal of American Bankers Association*, January, 1918, R. G. Dun & Co. *Rate Book*, *Hubbell's Legal Directory*, 1921. The New Hampshire and California provisions were secured by personal correspondence.

[2] National banks guilty of usury must forfeit all interest. They are allowed to charge whatever rate is permitted by the law of the state in which they are located. If usurious interest has been collected the party paying same may recover twice the amount paid. Section 5197, U.S. Revised Statutes.

A more complete summary of the state usury laws is given in Appendix E.

THE CHIEF PROVISIONS OF THE STATE INTEREST LAWS OF THE UNITED STATES, 1921

Name of State	Legal Rate	Lawful Limit	Penalty for Usury
Idaho	7	10	Forfeiture of entire interest. Can recover excess only if paid. Forfeiture also of ten per cent of principal to school fund.
Illinois	5	7	Forfeiture of entire interest. Cannot recover anything if paid.
Indiana	6	8	Forfeiture of excess interest over six per cent.
Iowa	6	8	Forfeiture of interest and costs.
Kansas	6	10	Forfeiture of double the amount of usurious interest.
Kentucky	6	6	Forfeiture of excess interest.
Louisiana	5	8	Forfeiture of interest.
Maine	6	no limit	No penalty.
Maryland	6	6	Forfeiture of excess interest.
Massachusetts	6	no limit	No penalty. (Except on loans of less than $1000.)
Michigan	5	7	Forfeiture of all interest.
Minnesota	6	10	Forfeiture of all interest.
Mississippi	6	8	Forfeiture of all interest.
Missouri	6	8	Forfeiture of excess interest.
Montana	8	12	Forfeiture of twice the interest.
Nebraska	7	10	Forfeiture of all interest.
Nevada	7	no limit	No penalty.
New Hampshire	6	no limit	No penalty.

THE CHIEF PROVISIONS OF THE STATE INTEREST LAWS OF THE UNITED STATES, 1921

Name of State	Legal Rate	Lawful Limit	Penalty for Usury
New Jersey.....	6	6	Forfeiture of interest and costs.
New Mexico.....	6	12	Forfeiture of double the interest if paid. Usury is also a misdemeanor punishable by a fine.
New York.....	6	6	Forfeiture of both principal and interest. Also misdemeanor. In case of banks loss of interest only, or, if already paid, twice the amount. This does not apply to call loans upon which there is no legal limit for interest to be charged. Corporations cannot plead usury.
North Carolina..	6	6	Forfeiture of interest. Double the amount may be recovered if paid.
North Dakota...	6	10	Forfeiture of all interest. Double the amount may be recovered if paid.
Ohio.....	6	8	Forfeiture of excess over six per cent.
Oklahoma.....	6	10	Forfeiture of twice the interest.
Oregon.....	6	10	Forfeiture of principal.
Pennsylvania....	6	6	Forfeiture of excess interest.
Rhode Island [1]...	6	30	Loss of principal and interest. Also fine and misdemeanor.
South Carolina...	7	8	Forfeiture of entire interest. Double the amount may be recovered if paid. Corporations cannot plead usury.

[1] For all practical purposes Rhode Island has no usury law in the field of commercial and investment loans. The Rhode Island law is intended to apply primarily to consumptive loans. The rate of thirty per cent is the maximum for loans exceeding fifty dollars. For loans under fifty dollars the maximum is sixty per cent per annum.

THE CHIEF PROVISIONS OF THE STATE INTEREST LAWS OF THE UNITED STATES, 1921

Name of State	Legal Rate	Lawful Limit	Penalty for Usury
South Dakota...	7	12	Forfeiture of interest. Usury is a misdemeanor.
Tennessee.....	6	6	Forfeiture of excess interest. Usury is a misdemeanor.
Texas.....	6	10	Forfeiture of all interest. Double the amount may be recovered if paid.
Utah.....	8	12	Forfeiture of principal and interest. Also misdemeanor.
Vermont.....	6	6	Forfeiture of excess interest.
Virginia.....	6	6	Forfeiture of all interest.
Washington.....	6	12	Forfeiture of amount of accrued interest, but, if interest be paid, then forfeiture of twice the amount.
West Virginia....	6	6	Forfeiture of excess interest. Corporations cannot plead usury.
Wisconsin.....	6	10	Forfeiture of all interest. Three times the excess may be recovered if paid.
Wyoming.....	8	12	Forfeiture of interest and costs.

PART TWO

THE HISTORICAL APPROACH TO THE PRESENT PROBLEM OF USURY LAWS

PART TWO

THE HISTORICAL APPROACH TO THE PRESENT PROBLEM OF USURY LAWS

CHAPTER IV

INTRODUCTORY

In a study of this nature, a critical examination of the past history of usury and usury laws will be of value only in so far as it relates to present-day problems. A brief description of early Hebrew, Greek, and Roman interest laws will reveal some of the reasons for the origin of the prohibitions against the taking of a compensation for the use of borrowed money. Mention of the canonistic prohibitions of usury during the Middle Ages will throw some light upon the evolution of modern interest laws. A short sketch of development of English usury laws will serve to show the models upon which American usury laws were based.

There have been in the past numerous writers upon the subject of usury, such as Francis Bacon, Besold, Grotius, and others whose contributions bear so remotely upon the present-day situation that they will not be brought into the discussion. For those who wish to go more thoroughly into the history of the theory of usury, several excellent books are available.[1]

Two of the writers on the subject of usury laws stand out preëminently because of their contributions. These

[1] Endemann's *Studien in der romanisch-kanonistischen Wirtschafts- und Rechtslehre* is probably the most important work which traces the origin and development of usury laws. W. J. Ashley's *Introduction to English Economic History and Theory*, §§ 22 and 65, discuss the problem in much shorter compass and with more freedom from bias. Eugen v. Böhm-Bawerk's *Capital and Interest* gives a very good brief survey of early usury laws from the point of view of the evolution of theories of interest. Other studies are listed in Appendix A., p. 189.

are Turgot[1] of France and Bentham of England, each of whom, it is said, produced an array of arguments and evidence sufficiently convincing to cause the repeal of the usury laws of his country.

It is particularly desirable to study Bentham carefully because of the influence which his writings have had upon English and American legislation. Although some economists regard him as having said the last word upon usury and usury laws, it is my opinion that his arguments were in error in several places. In fact, this entire historical approach is planned to lead up to a criticism and evaluation of Bentham and his work. An attempt will be made to show that, although Bentham did more than any other writer of the past to clear up the question of usury laws for English-speaking peoples, he did not face the ultimate issue, and that by evading this issue he contributed conspicuously to the delay of the solution of the problem of usury.

It is not an easy task to write upon a subject which has long been regarded as a field in which there are no important economic problems. Most economists are of the opinion that the only problem is that of getting rid of the usury laws.

[1] This study will deal with only the outstanding and really epochal contributions. There were many French writers long before Turgot who opposed usury laws, but they will be disregarded. No attempt will be made to give a detailed history of economic thought on the subject.

CHAPTER V

ANCIENT AND MEDIEVAL DOCTRINES

USURY laws had a noble and altruistic origin in the minds of rulers and legislators actuated by the highest motives. These statutes had a common origin with other laws which sought to regulate the prices of the necessities of life. Such laws aimed to protect the poor borrower against the rich lender and the poor consumer of the necessities of life against the profiteer.[1]

Alfred Marshall gives one of the best explanations of the original antipathy to the taking of interest. He says:[2]

> In primitive communities there were but few openings for the employment of fresh capital in enterprise, and any one who had property that he did not need for his own immediate use, would seldom forego much by lending it on good security to others without charging any interest for the loan. Those who borrowed were generally the poor and the weak, people whose needs were urgent and whose powers of bargaining were very small. Those who lent were as a rule either people who spared freely of their superfluity to help their distressed neighbors, or else professional money-lenders. To these last the poor man had resort in his need; and they frequently made a cruel use of their power, entangling him in meshes from which he could not escape without great suffering, and perhaps the loss of the personal freedom of himself or his children. Not only uneducated people, but the sages of early times, the fathers of the medieval church, and the English rulers of India in our own time, have been inclined to say, that money-lenders "traffic in other people's misfortunes, seeking to gain through their adversity: under the pretence of compassion they dig a pit for the oppressed."[3] In such a state of society it may be a question for discussion, whether it is to the public advantage that people should be encouraged to borrow wealth under a con-

[1] Richard H. Dana, Jr., Speech in the House of Representatives of Massachusetts, February 14, 1867, on the Repeal of the Usury Laws.

[2] Alfred Marshall, *Principles of Economics* (8th ed.), p. 584.

[3] Saint Chrysostom's Fifth Homily.

tract to return it with increase after a time: whether such contracts, taken one with another, do not on the whole diminish rather than increase the sum total of human happiness.

The sentiment against usury had its origin in tribal relationships in many other cases besides that of the Israelites, perhaps in all cases; and as Cliffe-Leslie remarks,[1] it was "inherited from prehistoric times, when the members of each community still regarded themselves as kinsmen; when communism in property existed at least in practice, and no one who had more than he needed could refuse to share his superfluous wealth with a fellow tribesman in want."

The foregoing explanation seems to apply to rather primitive states of society and certainly does not relate to the more developed economic organizations of people which historians characterize as the ancient civilizations.

Ancient Capitalistic Society

Ancient Babylonia developed a type of society which may fairly be called capitalistic. Money capital invested in slaves, agricultural enterprises, cattle, sheep, caravans, ships, buildings, irrigation projects, and stocks of goods, yielded returns on the investment.[2] With the growth of the great Babylonian cities there came an increasing division of labor. Many of the important commercial functions such as wholesaling, retailing, banking, accounting, manufacturing, and transportation, were gradually differentiated.[3]

The Code of Hammurapi,[4] King of Babylon about 2250 B.C., neither prohibited nor attempted to limit rates

[1] Cliffe-Leslie, Essays (2d ed.), p. 244.

[2] This is a fair inference from reading Morris Jastrow, *The Civilization of Babylonia and Assyria* (1915), chs. III and VI. Examples of business letters and documents are given on pages 326–40, 486–87.

[3] From somewhere about 400 B.C. when the Babylonians were under Persian dominion, but doubtless carrying on business in the old way, we have the account books of a Jewish firm of bankers and *entrepreneurs*, Murushû & Sons, recovered by a Philadelphia expedition and published by Albert T. Clay, *Business Documents of Murushû Sons of Nippur* (Philadelphia, 1904).

[4] An excellent translation and transliteration is that of Robert F. Harper, published by the University of Chicago Press in 1904.

of interest. Indeed, the ancient Babylonians had no word for usury in the sense of our legal definition of usury.[1] Sections 48–52 of the Code of Hammurapi provided that interest on agricultural loans might be paid in grain at market value where the debtor had no money, and shifted certain agricultural risks to the creditor by providing that there might be an abatement of interest in unforeseen cases where floods destroyed the crops of debtors. But interest was not canceled by neglect to raise a crop. The temples were the agricultural banks and most debts were owed to them. Loans without interest were frequently made as a kind of personal accommodation,[2] but the usual rate of interest for money loans was from five and one-half to twenty-five per cent.[3] Such rates were not greatly different from present-day rates in some of the newer American agricultural states.[4]

Usury among the Israelites

There is little doubt but that the prohibitions of the old Mosaic law grew out of the tribal relationships of the Israelites. The Jews, as they lived in Palestine, were a peculiar people, isolated, exclusive, without commerce, and without trade. They had very few modes of investing capital. Capital with them consisted of gold, precious stones, herds, and flocks. Under a theocracy, where the relations of the people must be kind and helpful, the Jews would not take money for their little loans which were usually mere accommodations between one another.[5]

[1] See C. H. W. Johns's article on "Babylonian Usury" in the *Encyclopedia of Religion and Ethics* (1922), vol. XII.

[2] Morris Jastrow, *Civilization of Babylonia and Assyria*, p. 338.

[3] *Ibid.*, pp. 326, 338. On p. 340 is given an English translation of a loan contract tablet which specifies the "usual rate of interest," indicating that there was a sort of market rate for such loans.

[4] See pp. 99–105 below. It must not be forgotten that the ancient Babylonian rates of loan charges included heavy costs of risks.

[5] Under the rules of the Talmud, if the money was to be used in a trading enterprise where a profit was expected, a sort of fictitious partnership arrangement could be set up by which the moneyed man could

Moses wrote:

If thy brother be waxen poor, and fallen in decay with thee; then thou shalt relieve him; yea, though he be a stranger, or a sojourner; that he may live with thee. Take thou no usury of him or increase; but fear thy God; that thy brother may live with thee. Thou shalt not give him thy money upon usury, nor lend him thy victuals for increase.[1]

Thou shalt not lend upon usury to thy brother; usury of money, usury of victuals, usury of any thing that is lent upon usury. Unto a stranger thou mayest lend upon usury, but unto thy brother thou shalt not lend upon usury.[2]

Among the Greeks the rates of interest were left almost entirely free from legal restriction. The only enactments in Athens relative thereto were the following: (1) "A banker shall demand no more interest money than what he agreed for at first"; and (2) "Let usurer's interest money be moderate."[3] Twelve per cent was the current rate, but on money lent to prosecute a six months' sea voyage thirty per cent was charged on each voyage,[4] which charge, as two or three such voyages were often made in one year, was generally equivalent to sixty per cent per annum. In those days of unskillful navigation with seas infested with pirates, this rate was not so unreasonable as it may appear at first sight. The profits of successful voyages were proportionately high. At Corcyra in the second and third centuries B.C. loans on good security com-

lawfully receive a return on the sum advanced. This is described by Joseph Jacobs in the article on "Usury" in the *Jewish Encyclopedia* (Funk & Wagnalls, 1906), vol. 12, p. 389. This arrangement seems to recognize the difference between consumptive loans and productive loans.

Such special partnerships date back a very long time. Similar partnerships were fully regulated by King Hammurapi in §§ 100–107 of his code of laws for Babylon four thousand years ago. See pages 38–39 above. For additional evidence that numerous loans among the Israelites were productive, see H. E. Goldin, *Mishnah Baba Meziah* (1913), ch. v.

[1] Leviticus XXV, 35–37. [2] Deuteronomy XXIII, 19, 20.

[3] Potter, *Antiquities of Greece* (ed. Professor Anthon), p. 150.

[4] *Voyage d'Anacharsis*, tome IV, p. 371.

manded twenty-four per cent, while the rate at Athens at the time of the orators varied from twelve to as high as eighteen per cent.[1] These high rates were due partly to the dearth of capital [1] and partly to the cheapness of labor in those days, the rate of interest being determined by the returns to capital which in slave states absorbs all that is produced except the barest minimum of subsistence.[2] These high rates were very oppressive to agriculturists whose fortunes were always precarious. From this class the words for interest both in Greek and Latin (*tokos*, *fœnus*) were taken. Interest was "produce" or "offspring." Upon this was based the metaphysical argument of Aristotle against interest. He pronounced all interest unnatural and unjustifiable on the ground that a coin in itself is barren and could not have "offspring." [3] This notion, although it arose from a curious coincidence of terminology, later came to dominate European thought for many centuries.[4]

According to Livy and Tacitus there were no laws respecting usury in Rome for three centuries or more after the founding of the city.[5] Interest was fixed at five per cent in 347 B.C.,[6] but in 342 it was abolished by the Lex Genucia.[7] It was soon found, however, that prohibitions of interest were unenforcible and by a decree of the senate in 50 B.C. the lawful maximum for interest became twelve per cent throughout the Roman provinces. Later the Code of Justinian provided a usury law which became a model for laws in other countries. This law established a series of maximums based upon a classification of the ranks of society.

The teachings of the Hebrew Scriptures had a powerful influence upon the opinions of the leaders in the early

[1] Palgrave, R. H. I., *Dict. Pol. Econ.*, vol. II, p. 429.
[2] Roscher, *Ansichten der Volkswirthschaft*, I, 181.
[3] Aristotle, *Politics*, bk. I, ch. 10, 4, 5.
[4] This became one of the chief arguments of the Church fathers against usury.
[5] Tacitus, *Annals*, lib. VI, xvi, 3. [6] Livy, lib. VII, c. 27.
[7] Palgrave, R. H. I., *Dict. Pol. Econ.*, vol. II, p. 430.

Christian Church. Following out the Biblical prohibitions of interest, the great fathers of the Church, such as Chrysostom, Tertullian, and others, were all opposed to interest of any kind. This unanimity of opinion on the subject resulted in numberless edicts and decrees by popes, councils, kings, and legislatures over a period of more than fifteen hundred years.[1] The prohibition of usury became, in fact, the center of the canonist doctrines.[2]

Professor T. N. Carver offers the following explanation [3] of the antipathy of religious leaders against the taking of interest:

> The distinction between borrowing for a productive purpose and borrowing to pay living expenses will help to explain why religious leaders in times past have been opposed to interest. It is undoubtedly a bad practice for men to borrow money with which to buy articles for consumption, except in the most extreme cases. Articles for consumption are goods which are used to satisfy desires rather than to assist in production. Before the days of expensive machinery, when capital was not an important factor in production, such a thing as borrowing for productive purposes was practically unknown. The only borrowing that was done was for the purpose of buying non-productive goods. This is a bad practice.
>
> The question may be asked, however, why did not the early guardians of society forbid borrowing instead of forbidding the taking of interest? The reason was that so long as the usurers were permitted to offer loans, many short-sighted people would yield to the temptation to borrow. Since the purpose for which they borrowed added nothing to their earning capacity, they were in no better position to accumulate money after they borrowed than they had been before. If they had been able to accumulate anything before, they would not have needed money. The fact

[1] Funk, F. X., *Geschichte des kirchlichen Zinsverbotes*, 6. See also Endemann, W., *Studien in der romanisch-kanonistischen Wirtschafts- und Rechtslehre*, vol. I, pp. 1–70, for a history of papal and other edicts, decrees, etc. See also the brief historical summary of ancient usury laws given by Chancellor Kent in Dunham *v.* Gould, 16 Johns. (N.Y.) 367, 8 Am. Dec. 323.

[2] Ashley, W. J., *Introduction to English Economic History and Theory*, vol. II, pp. 395–405.

[3] T. N. Carver, *How to Use Farm Credit*, U.S. Department of Agriculture, Farmers' Bulletin 593, June 3, 1914, p. 3.

that they had not been able to accumulate anything before would be pretty conclusive proof that they would not be able to accumulate enough to pay the debt. Therefore, they put themselves into the clutches of the usurer.

Rightly or wrongly this was the attitude of the early religious and moral leaders on the subject of usury or interest. Instead of forbidding short-sighted borrowing, as all borrowing for purposes of consumption is, they went to the root of the matter, and attacked lending for interest.

Dr. Wilhelm Endemann [1] tells us how the business world managed to evade these prohibitions of interest. Methods were devised which did not conflict with the laws. For instance, the leading Church fathers approved of the doctrine of *damnum emergens*, by which, if a lender suffered loss by the failure of a borrower to return a loan at a date named, compensation might be made. By the doctrine of *lucrum cessans*, if a man in order to lend money was obliged to diminish his income from productive enterprises, it was claimed that he might receive in return, in addition to his money, an amount exactly equal to this diminution in income. These two conceptions of "actual loss incurred" and "certain gain lost" were the basis of the idea of *interesse*, or interest, which originally was a penalty exacted from the borrower for neglect to pay the debt at a certain time. After a time it came to be the practice that loans were made nominally without interest, but the lender actually received, under the name of *interesse*, a regular percentage for the whole period of the loan, the borrower by a fiction being assumed to be guilty of culpable neglect (*mora*) for the period.[2]

It is interesting to note that in that age when the statu-

[1] Endemann, W., *Studien in der romanisch-kanonistischen Wirthschafts- und Rechtslehre*, vol. II, book VIII, *Das Interesse*, pp. 243-317. This is later described in Böhm-Bawerk, *Capital and Interest* (William Smart's translation), pp. 26–27.

[2] There were, of course, other ways of evading the prohibitions of usury, such as the buying of annuities, the taking of land in mortgage for lent money, the use of bills of exchange, and partnership arrangements. These are described by Endemann, vol. II, pp. 242, 366.

tory maximum for interest charges was zero, with severe penalties for violations, it was found not difficult to get around the prohibitions, just as to-day in the United States, where statutory maximums are from six to twelve per cent, no great difficulties are encountered by those who wish to contract for charges beyond the legal limits.

With the Reformation the canonist doctrines came up for review. The general trend of the opinion of reformers was that loan interest was a parasitic profit, admitting of no defense before any strict tribunal; but they consented to a practical compromise with the frailty of man, believing that interest was tolerable as a concession to his imperfection.[1] Calvin[2] and Molinæus,[3] however, were convinced of the necessity of interest on loans. Molinæus, in refuting the arguments of the canonists, found that they misinterpreted the Scriptures. He pointed out that in practically every loan there is an "*interesse*" of the creditor — some detriment caused or some advantage foregone — for which compensation should be paid. Calvin's position was somewhat similar.

In the seventeenth century the pressure of rising commercial interests, and the necessity of recognizing what was actually taking place in business, were powerful factors in overthrowing the canonist doctrines. This was true particularly in the Netherlands, where commerce was developing a complete system of banking and credit. There, transactions involving the taking of interest were very common and the practice had the sanction of temporal legislation. In 1638 Claudius Salmasius, in his "De Usuris," succeeded where his predecessor Molinæus a hundred years before had failed, in convincing the public of the fallacies in the canonists' arguments against interest. His ideas were taken principally from Molinæus, but he excelled in the way he arranged his arguments and in his presentation.

[1] Palgrave, R. H. I., *Dict. Pol. Econ.*, vol. II, p. 432, and Böhm-Bawerk, *Capital and Interest* (Smart's translation), p. 27.

[2] Calvin, *De Usuris Responsum*, 1579.

[3] For discussion of Molinæus, see Endemann, *Studien*, vol. II, book X, p. 378.

In 1545, recognizing the needs of business and commerce, England had legalized the taking of interest by the Statute of Henry VIII,[1] because, as the act declared, "the statutes prohibiting interest altogether had so little force that little or no punishment ensued to the offenders." In that year a charge of ten per cent per annum for the use of money was made legal and anything over this amount was forbidden as usury. This act not only was the original of the later usury statutes in England up to the repeal of the usury laws, but was also the original source of all the various state usury laws in the United States. They differ from each other only in detail.

The statute of Henry VIII enacted in 1545 was repealed by 5, 6 Edward VI, c. 20, seven years later, but reënacted by 13 Elizabeth, c. 8, in 1571. The maximum rate was reduced to eight per cent by 21 James I, c. 17, in 1624, and to six per cent by 12 Charles II, c. 13, in 1660, and finally to five per cent by 12 Anne, c. 16, in 1713, at which point the rate remained until all usury laws in England were repealed by 17 and 18 Victoria in 1854. The Statute of Anne was the law in force when most of the American colonial usury laws were enacted.

Previous to the Statute of Henry VIII there had been a long series of enactments — the statutes of Alfred, of William the Conqueror, of Henry II, of Henry III, of Edward I, of Edward III, and of Henry VII — which were mere penal enactments prohibiting the lending of money upon any interest whatever, under punishment more or less severe ranging from forfeiture of chattels, lands, and Christian burial, under Alfred, to a loss of all substance, whipping, exposure in the pillory, and perpetual banishment, under William the Conqueror. Up to the time of Henry VII, the canonical law of England also prohibited usury, but as time went on the power of the Church in such matters grew weaker, so that it could do very little.[2] By

[1] 37 Henry VIII (1545), ch. 9.
[2] Cunningham, W., *Growth of English Industry and Commerce*, p. 223.

the statute 8 Henry VII, c. 6, the laws against usury were definitely taken out of the canonical laws of England.[1]

But the prohibitions of usury came originally from the Corpus Juris Canonici or ecclesiastical law of England, which in turn was derived from the decrees of the popes and teachings of the Church fathers. The origin of all English usury laws was an ecclesiastical statute or "constitution" of Edmund, Archbishop of Canterbury.[2] [3] Translated into English by Richard Burn it reads: [4]

> We forbid any man to detain a pledge, after he hath received the principal out of the profits, after deduction of the expenses, for this is usury.

In 1668, Sir Josiah Child, after noting that the wealth of Holland toward the end of the seventeenth century was accompanied by a low rate of interest, and believing that the relation between the two was that of effect and cause, published his "Discourse of Trade" in which he held that prosperity might be secured for England by a reduction in the maximum rate of interest to four per cent. This idea was, of course, opposed by several contemporary writers, some of whom condemned all statutory maximums for interest rates.[5] In 1692, John Locke anonymously published a tract entitled "Some Considerations on the Lowering of Interest and Raising the Value of Money," in which he controverted the views of Sir Josiah Child. In this he pointed out that generally speaking, the price of the hire of money cannot be fixed by law, and that any attempt to fix the rate of interest below the true and natural value can only harass trade and is sure to be defeated by the devices

[1] See Reeve, *History of English Law*, vol. IV, p. 204; vol. V, pp. 292–93.

[2] Burn, R., *Ecclesiastical Law*, vol. IV, p. 40.

[3] *Corpus Juris Canonici Decretals Sext.*, book 5, title 5.

[4] Lyndwood, Wm., *Provinciale* (1501), book III, title "De Pignoribus," folio 89a.

[5] Sir William Petty published a treatise in 1682 condemning statutory maximums for interest rates.

of expert traders. Locke had already pointed out in 1668, in answer to Child, that the example of Holland did not prove that a low rate of interest fixed by law was the cause of national wealth; for in Holland there was no law limiting the rate of interest at all, and the low rate was owing to the abundance of ready money. On the other hand, he adduces two reasons why there should be legal regulation of interest. One is that there may be a rule of practice for courts of law in assessing debts and damages. The other is that thoughtless borrowers, "young men and those in want, might not too easily be exposed to extortion and oppression," a line of thought afterward adopted by Adam Smith.

During this period France was far behind both in theory and practice. The French laws against interest were known as the most severe in Europe. But in the latter half of the eighteenth century there occurred in France an event which was to have a profound effect upon the entire question of interest laws. This was the renewal, by Pothier, a French jurist, and Turgot, of the controversy as to the justification of interest.[1]

[1] See Böhm-Bawerk, *Capital and Interest* (Smart's translation), pp. 48, 51; also Palgrave, *Dict. Pol. Econ.*, vol. II, p. 433.

CHAPTER VI

TURGOT

THE immediate occasion which caused Turgot to write his essay on *Les Prêts d'Argent* was the existence of a monetary crisis in Angoulême, a part of the province of which he was intendant from 1761 to 1774.[1] A feature of this crisis was an excessive number of accommodation bills upon advances to borrowers for purposes of unproductive consumption.[2] Furthermore, because of the rather speculative nature of the chief industries of Angoulême, it had come about that for nearly forty years back most negotiations had been on the footing of eight to ten per cent per annum, while six per cent was regarded as the normal rate in other parts of France.[3] Notwithstanding the edict of 1766 by which the French king had attempted to reduce the legal rate of interest from five per cent (since 1665) to four per cent, money continued to be lent in France at rates above the maximum, the law being safely and easily evaded in several ways.[4]

After a series of suspensions of payment, failures,[5] and bankruptcies, the bankrupt borrowers of Angoulême, unable to get further advances, combined to prosecute the creditors under the usury laws.[6] Turgot procured the removal of the cases from the local courts to the council of state, and drew up for its guidance his memorandum "Sur les Prêts d'Argent" in defense of interest.

[1] Stephens, *Life of Turgot* (1895), p. 70.
[2] Palgrave, *Dict. Pol. Econ.*, vol. II, p. 433.
[3] Stephens, *Life of Turgot*, p. 70.
[4] Adam Smith, *Wealth of Nations* (1784), book II, ch. 10, p. 45. Quoted by Bentham, Letter VII, *Defense of Usury* (1787).
[5] Turgot, *Les Prêts d'Argent*, 611.
[6] Palgrave, *Dict. Pol. Econ.*, vol. II, p. 433.

Léon Say in his "Turgot" summarizes this work as follows: [1]

Dividing his subject into three parts, in the first he established the necessity of interest-bearing loans for the exigencies of trade and industry and proves that the rate is variable in proportion to the abundance or scarcity of capital and to the nature of the risk. In the second part he refutes the arguments of scholastic philosophers, of jurisconsuls and of theologians. In the third part he seeks the historic causes of the hatefulness of usury and of the bad reputation of money-lenders.

Finally in a strong-based conclusion, he prays that interest-bearing loans be legalized and that the rate be left to the free agreement of borrower and lender, and that usurers who prey upon the passions and inexperience of youth be punished only by the laws relating to breach of confidence and other kinds of imposition.

Like Adam Smith, Turgot adopted the standpoint of individualism, that a man has a right to do what he will with his own, and that, on the whole, this liberty is most conducive to the general well-being.

Pothier and his school had argued that, in a contract which was not gratuitous, equity demands that there must be an equality in the values exchanged. He contended, following the arguments of the canonists, that if interest is taken this equality is destroyed.

Turgot answered with the following: [2]

Between values exchanged, or between articles given and received, there is no such thing as metaphysical equality or inequality. Equality of value depends upon the opinion of the contracting parties touching the degree of utility of the articles exchanged, for the satisfaction of their desires or needs. Having discussed inequality, they allege as an example of inequality the fact that the borrower, in returning more than the principal, gives back more than he received; and they infer that this is unjust. Such reasoning takes it for granted that the money received today and the money which is to be returned in a year, are two things perfectly equal. Is there not, on the contrary, an obvious difference between the two values — so obvious as to be recog-

[1] Léon Say, *Turgot* (Anderson's translation, 1888), p. 81.

[2] Turgot, *Mémoire sur les Prêts d'Argent*, § 27. See also § 23 of the same work.

nized by the proverb, "A bird in the hand is worth two in the bush"?

. . . . . .

If these gentlemen supposed that a sum of a thousand francs and a promise of a thousand francs are exactly of the same value, they advance a still more absurd proposition; for if the two things were of equal value why should any one borrow at all?

Turgot attacks the idea of statutory maximums for interest rates in the following arguments:[1]

There is no reason for a law which fixes the rate of interest. The rate ought to be, as is the price of all commodities, fixed by the agreement between the two contracting parties and by the relation of supply and demand. . . .

The rate of interest is, moreover, even more difficult to fix than is the price of any kind of merchandise because the rate of interest follows circumstances and considerations much more delicate and variable than does the price of a commodity, which are the time of making the loan, the time at which payment is stipulated, and especially the risk or the opinion of the risk which the capital must run. This opinion varies from one time to another; a momentary alarm, a series of bankruptcies, rumors of war, can cause a general uncertainty which suddenly tightens all negotiations for money. The opinion and the reality of the risk vary still more from one man to another and are augmented or diminished in all possible degrees. Consequently there must be just as many variations in the rate of interest.

A commodity may have the same price all over the country because all the people pay for it with the same money, and commodities in general use, whose production and consumption proportion themselves naturally the one to the other, have for long times had very nearly the same price.

But the money in a loan has neither the same price among all men, nor at all times, because in the loan, money is exchanged for a promise, and even if the money of all purchasers is all alike, the promises of all borrowers do not resemble each other.

To fix by a law the rate of interest is to deprive of the expedient of the loan, whoever cannot offer security proportioned to the lowness of the rate of interest fixed by the statute; it consequently renders impossible a multitude of commercial enterprises which cannot be carried on without risk of capital.

[1] Turgot, *Mémoire sur les Prêts d'Argent*, § 36. (This section translated by F. W. Ryan, 1924.)

Turgot's "Memorandum on Loans of Money" saved the day for the money-lenders of Angoulême and was so convincing in its presentation of arguments that at the time of the French Revolution the National Assembly declared all loans on interest legal, thus repealing the old usury laws. Turgot's controversy with Pothier marked the end of three centuries of conflict between the economists and the canonists.

The work which Turgot thus accomplished for France was done in England by Jeremy Bentham in his "Letters in Defense of Usury," published in 1787. In this work he disposed of the existing arguments in favor of statutory maximums for interest rates.

CHAPTER VII

BENTHAM

BENTHAM not only used the most effective arguments of his predecessors, but contributed new ones of his own, so that his "Letters in Defense of Usury," although rather poorly arranged and somewhat difficult to follow, is an unanswerable polemic against attempting to control commercial interest rates by statute. His task was simplified by the fact that the canonists' doctrines having been overthrown, he did not have to justify the taking of interest. He therefore concentrated all his arguments on the one problem of the limiting by law of the rate of interest. Being both an economist and an authority on jurisprudence, he approached the subject from both points of view.

Following Adam Smith and Turgot in the individualist theory that a man has a right to do what he will with his own, Bentham first states his theorem:

> That no man of ripe years and of sound mind, acting freely and with his eyes open, ought to be hindered, with a view to his advantage, from making such bargain, in the way of obtaining money, as he thinks fit; nor (what is a necessary consequence) anybody hindered from supplying him, upon any terms he thinks proper to accede to.

He points out that this proposition, were it to be received, would level at one stroke all the barriers which law, either statute or common, have set up against the taking of interest.

He argues that since contracts in general ought to be observed, if this is one of the exceptions to the rule (for doubtless some there are) which the safety and welfare of society require should be taken out of the rule, it lies upon him who alleges the necessity of the exception to produce a reason for it.

He then lists the five arguments in favor of statutory maximums for interest rates which he proposes to refute. They are:

1. Prevention of Usury.
2. Prevention of Prodigality.
3. Protection of Indigence [Poverty] against Extortion.
4. Protection of Simplicity against Imposition.
5. Repression of the Temerity of Projectors [Promoters].

In disposing of the first argument, he ignores the canonist arguments formerly used by Thomas Aquinas and Pothier, since they no longer had any weight in England. Aristotle's celebrated argument about the barrenness of money, to Bentham is merely the occasion for a witty remark. He shows that to argue that the law is necessary to prevent usury is simply begging the question.

He next refutes the idea that there can be a correct rate of interest by showing that no one rate of interest is more proper than another. Amplifying Turgot's argument [1] on this point,[2] he shows that the statutory maximums had been ten, eight, six, and five per cent in England at different times, and that at any given time rates vary widely from country to country. But Bentham's supposition that the rate of interest is merely a matter of convenience is not as strong as Turgot's theory that the rate of interest varies with the supply of loanable capital, the duration of the loan, and the risks involved.[1]

He says further:

> For him who takes as much as he can get for the use of any other sort of thing, a house, for instance, there is no particular appellation, nor any mark of disrepute: nobody is ashamed of doing so, nor is it usual so much as to profess to do otherwise. Why a man,

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[1] See p. 50 above.

[2] Turgot had also said, in § 45 of his *Mémoire sur les Prêts d'Argent*, "It is still another error to think that there is in commerce a rate of interest above which negotiations become usurious and criminal." The heading of § 45 reads, "The rate of interest above six per cent ought no longer to give a pretext for criminal action."

who takes as much as he can get, be it six, seven, or eight, or ten per cent *for the use of a sum of money* should be called usurer, should be loaded with an opprobrious name, any more than if he had bought a house with it and made a proportionable profit by the house, is more than I can see.

Taking up the second point, Bentham argues that interposing to prevent prodigality is not necessary to the existence of society, and is a sort of paternalism or work of supererogation. He also shows that it is not natural or customary for the spendthrift to give a rate of interest above the ordinary market rate to supply his wants. He will usually spend what he has before he wants to borrow. Then, when his money is all spent and he has no security to offer, he cannot borrow at any rate, but usually gets advances from his friends who, because of their friendship for him, make the interest a secondary matter. Furthermore, a statutory limit for interest rates cannot prevent the prodigal from buying goods on credit where he may, by reason of the terms, be paying the equivalent of an exorbitant rate of interest. In fact, the law may be the means of compelling him to do this, since he may want the money to buy goods.

He next takes up the argument that statutory maximums are necessary to protect the indigent or poverty-stricken against extortion. He contends, as Turgot [1] had done, that no one rate can be equally suited to all situations. He next advances the argument that some poor people may have to borrow at rates above the legal limit to avoid a loss. Such a situation may happen quite frequently. Bentham points out that even if the borrower had to pay a high rate he might conceivably be much better off for the borrowing. He is here anticipating the arguments of the remedial loan associations in the United States. He does not, however, foresee the difficulties which later attended the removal of maximum limits in the case of consumers' loans, and in fact does not recognize the difference between consumptive

[1] See p. 50 above.

loans and productive loans.[1] He does not work out a solution of the problem of properly controlling loans to persons in want to protect them from extortion, which was earlier raised by John Locke.[2] It apparently does not occur to Bentham that a higher maximum might be established for consumers' loans as has been done in many jurisdictions in the United States. The various small-loan laws have fixed maximums of from thirty per cent up to sixty per cent, but Bentham very likely would oppose such laws according to the principles upon which he denounces the Statute of Anne. Nevertheless, his arguments are perfectly valid in regard to the old English usury laws and for the maximums of all the old usury laws now (1924) in effect in the United States.

In taking up the argument that usury laws are necessary to protect the simple, he answers that, if a man is so simple as to need protection, he needs it more in buying goods than in borrowing money, as he will buy goods many times more frequently than he will borrow money. He says that no simplicity short of idiotism can render an individual so bad a judge in this case as the legislator.

He writes a special letter (XIII) to Adam Smith to combat the argument advanced by him [3] that projectors or promoters ought to be repressed to prevent the waste and destruction of capital in risky undertakings and that usury laws would help to accomplish this.

He first points out that it is a fallacy to say that projectors ought to be discouraged because: (1) In every period of history the projectors have helped to improve society by new processes and new improvements in the arts. (2) Restraints cannot lessen the proportion of bad projects to good ones, but merely have the effect of diminishing the

[1] See pp. 8–9, 25 above. [2] See p. 47 above.

[3] Adam Smith had said, in book II, chapter IV of his *Wealth of Nations* (1784), that if the legal rate of the interest were permitted to be as high as ten per cent, most of the money loaned would go to projectors and prodigals who would waste it and keep it out of the hands of those who would use it to the best advantage.

number of projects. (3) The rulers of the state are the ones most likely to ruin it, not the people. They themselves are the greatest spendthrifts in society.

He says that the ruin of every projector without exception would not be sufficient to disprove the utility of projects, and that in view of the fact that the projector takes great risks to make improvements in the arts, and either sustains great losses, if he fails, or makes big profits, if he succeeds, it is right to charge him high rates of interest, and since he is willing to pay high rates the law ought not to interfere.

He also points out in Letters VI and VIII several ways in which the usury laws accomplish harm to the commonwealth. (1) Fixing a rate of interest also fixes a minimum security. Persons who cannot furnish this security cannot borrow. This was advanced also by Turgot.[1] (2) The effect is to raise the rate higher than it would naturally have been, because the lender, in addition to requiring insurance against the ordinary risks of lending, must now charge more in order to make up for the extra risk of being prosecuted for usury. He has to be indemnified against the Law. Law-abiding lenders withdraw from the field, and those who remain, because of the scarcity of loanable funds for this type of loan, can charge higher rates. (3) The law being continually broken creates in the popular mind a disregard for law. (4) Such laws corrupt the morals of the people by encouraging borrowers to enter into usurious contracts in order to take advantage of lenders. (5) Such laws declare something to be a crime which is no crime at all. This was also Turgot's contention.[2] (6) There are a great many ways of evading the law, such as commissions, fees, selling accepted bills at an undervalue, etc. (in Letter VIII). (7) The laws are inconsistent in that there is no statutory maximum for interest rates in cases of bottomry and respondentia bonds. (8) Other cases are not regulated

[1] Turgot, *Sur les Prêts d'Argent*, § 36. See p. 50 above.
[2] *Ibid.*, §§ 38, 45.

where men take unlimited risks and receive unlimited compensations.

Bentham's "Letters in Defense of Usury" contain many other lines of argument which were particularly applicable to the situation in England at the time, but most of which have no bearing upon the present problem in the United States.

This celebrated polemic so effectually silenced all the arguments in favor of statutory maximums for interest rates that counter-legislation began to be enacted whittling away the scope of the statutes in various ways, and finally, in 1854, all the English acts against usury were repealed.[1] [2]

In Denmark they were repealed in 1855; in Spain, in 1856; in Sardinia, Holland, Norway, and Geneva, in 1857; in Saxony and Sweden, in 1864; in Belgium, in 1865; and in Prussia and the North German Confederation, in 1867.[3]

[1] See p. 45 above.

[2] See Extract from the Report of the Committee on the Usury Laws, laid before the House of Commons in 1818, in Appendix B, p. 196 below.

[3] Palgrave, *Dict. Pol. Econ.*, vol. II, pp. 433–34.

CHAPTER VIII

EARLY DEVELOPMENTS IN NEW YORK AND MASSACHUSETTS

Soon after the period in which the "Mémoire sur les Prêts d'Argent" and the "Letters in Defense of Usury" appeared, the convincing arguments therein contained began to have their effect upon the legislators of America. Efforts began to be made in many different states to lessen the severity of the penalties of the American usury laws or to have them repealed or modified.

A notable contribution to the literature on the subject of usury was a petition signed by 202 of the business men of Boston and presented to the legislature of Massachusetts in 1834, requesting the repeal of the maximum limit on interest rates.[1] After being considered by a special committee, this petition was favorably reported upon and a bill was introduced to repeal the usury law, but it failed to pass.

In 1846 the entire country was astounded and made indignant by the celebrated case of the New York Dry Dock Bank versus the American Life Insurance and Trust Company.[2] The Dry Dock Bank, during a period when its credit was impaired and when money was difficult to borrow, had negotiated a loan contract with a certain James Morrison of London through the intervention of the trust company.[3] In this contract the bank received £48,000 sterling ($220,000 to $230,000) for its promise to pay £50,000 in London with six per cent interest. The

[1] A copy of this petition and the committee's report of it are found in Appendix C. See p. 197.

[2] 3 Sandford, 215, 3 N.Y. 344, 3 Comst. 361.

[3] An account of this case is given in the *New York Journal of Commerce* of January 5, 1850, and *New York Evening Post* of February 23, 1850.

loan was secured by a mortgage of real estate, and there was a further agreement to pay to the trust company in New York the several installments of the £50,000 at the rate of five dollars for each pound sterling, with interest at seven per cent.

In the lower court the decision was for the bank, but it was reversed by the state supreme court. Finally when the case was taken to the court of last resort, the Court of Appeals, the decision of the lower court in favor of the bank was affirmed (1849). It was held that the reservation of 2000 pounds, or four per cent on the principal sum, in addition to the six per cent of the contract rendered the contract usurious, and that the bank was under no legal obligation to return the money to the lender.

The "Journal of Commerce" commented on it thus:

> It shows more impressively than anything which has before come to our knowledge, the abominable injustice of the [usury] law which is a disgrace to our statute book, to the legislature which enacted it, and to the people which tolerate it. . . . It offers a standing premium for fraud, deception, ingratitude, and downright robbery; a premium, in the case before us amounting to something like $400,000 [principal and interest].

The "New York Evening Post" had this to say:

> This usurious loan sustained the sinking credit of the banking house that made it and enabled it to discharge its pressing liabilities and preserve unimpaired its charter, but its directors, in order to relieve themselves of its payment guaranteed by the most solemn obligations, set up a defense which not only enabled them to take advantage of their own wrongs, but to swindle and defraud innocent parties out of a just and equitable demand.
>
> This company is now conducting business, on a capital made up in part of this loan, which, under the miserable subterfuge of *usury*, they evaded paying, and have at last succeeded in locking up in their vaults. . . . Well may the business community look upon a law with horror and detestation which gives such advantages to knavery and dishonesty; and enables the fraudulent and immoral debtor to exempt himself from the payment of a debt.

Soon, as a result of this decision, efforts were made to have the New York usury law repealed. But great diffi-

culties were encountered. After a lot of debate on the subject, the legislature enacted in 1850 an amendment which was entitled, "An act to prohibit corporations from interposing the defense of usury in any action," [1] which law, it was alleged, was necessary in order to prevent any repetition of the successful defense of usury which had just been decided in favor of the bank in question. This explains why in New York corporations cannot plead usury. This act took away much of the scope of the usury law. The law has been whittled away in other particulars since then, namely, by the exemption of call loans from the law; by the enactment of a small-loan law taking consumptive loans out from its control; by reducing the penalty in the case of banks so that they forfeit interest only in case of usury,[2] and by court decisions which make it legal for note brokers to sell commercial paper at any rate or discount at which they can find purchasers.[3]

It is, of course, impossible to go into the history of all the legislative enactments of the various states on the subject of usury. However, as an excellent example of a committee report on usury laws of the period before the Civil War, may be cited "The Report of the Joint Select Committee upon the Interest Laws with Accompanying Documents, to both Houses of the General Assembly of Tennessee," of December, 1859, an extract of which is given in the Appendix of this monograph.[4] This report recommended the repeal of the usury law of that state, but the law still stands on the statute books to this day (1924).

Influenced probably by the repeal of the usury laws of England in 1854, the proposition came up in the legislature of Massachusetts in 1867 to repeal the Massachusetts law. The Representative Richard H. Dana, Jr., prepared a remarkable speech advocating the measure, which was so con-

[1] See New York Senate Document no. 40, March 1, 1851.
[2] If interest has been already paid, twice the amount.
[3] *United States Investor*, July 24, 1920.
[4] See Appendix D, p. 203.

vincing that that commonwealth, which had enacted the first usury law in America in 1661, abolished the statutory maximum for interest rates and has never seriously considered reënacting it.

Dana's speech stands unique among all the writings on usury laws because of its clearness, convincingness, and style of presentation. It is a masterpiece of persuasive argument and is probably the most effective political speech ever delivered on the subject, although it is chiefly made up of arguments used by Turgot and Bentham.

The strength of Dana's speech lies in its emphasis. Whereas Bentham's arguments, being directed to economists, spent some time in demolishing two or three contentions in favor of statutory maximums never seriously considered by lawmakers, Dana, while not neglecting these considerations, concentrates his attention upon the actual motives that have caused legislatures to enact usury laws, the two most prominent of which are: to fix the price of money, and to prevent the lender from taking advantage of the necessity and inexperience of the borrower.

His entire argument is that usury laws should be repealed because they are futile and mischievous.

He first briefly reviews the fallacy of sumptuary laws in general, and then shows that a maximum limit for interest rates will have no effect because the market price of money is a resultant of economic forces which cannot be controlled by a legislative enactment. He brings in evidence to show that the usury laws are obeyed only when the market is below the maximum, and that when the market goes above the maximum the laws are invariably broken. He also reviews the mischiefs wrought by usury laws, as Turgot and Bentham had done.

He lays great emphasis upon the fact that a statutory maximum makes no allowance for differences between loans as to risks, and shows the absurdity of asking a capitalist to lend to those who put up good security, to those who put up poor security, and to those who put up

no security at all, at the same maximum rate of six per cent. He cites the report of a committee of the English Parliament on the subject of usury laws, prepared in 1818.[1]

Dana also points out that the economic forces which work together to establish the market rate of interest are becoming stronger and stronger as the commerce and industry of this country become more and more developed. As capital accumulates, competition between lenders to make loans becomes greater and greater, so that there can be no monopoly of the money market.

He reminds his hearers that the usury laws operate to keep savings banks from getting a just price for the money they lend, and that this is an injustice to the class of people who invest in savings banks, who are the very people that the usury laws were enacted to protect.

He then refutes the argument that if the maximum were repealed the banks could combine to keep up an artificial rate of interest, by showing that in this country, where there is keen competition between banks for business, such a thing could not happen, and that, furthermore, if interest rates should rise, there is nothing to prevent foreign money, which would be thus attracted, from coming to this country for investment.

[1] See Appendix B, p. 196.

CHAPTER IX

DOCTRINES OF LATER ECONOMISTS

Although Bentham's polemic was sufficient to establish firmly the doctrine that general statutory maximums for loan charges, popularly known as "usury laws," [1] are futile, mischievous, and unnecessary, a number of recent economic writers have contributed other theories which have strengthened it. The present chapter will briefly survey some of these contributions.

The present inquiry is concerned but incidentally with theories of pure interest. It finds a theory of interest useful only when a tenable theory of usury [2] can be derived or implied from it. It finds no justification for a lengthy discussion of the services of capital [3] or for a detailed presentation of all the various theories of interest that have been worked out by economists.[4] Although interest and usury were synonymous terms in primitive tribal society, they are not so to-day in modern industrial society. Indeed, the keynote of this essay is given by its emphasis

[1] The term "usury law" does not include pawnbroking laws or small-loan laws. See passages on pp. 3, 12, 18, and 21 above.

[2] Theories of usury may be of two kinds: (1) theories of statutory limitation of loan charges or legal usury, and (2) theories of prevention of exploitation of needy borrowers, or moral usury. See pp. 14–16 above.

[3] For studies of the services of capital, see F. W. Taussig, *Principles of Economics* (1921), ch. 38; T. N. Carver, *Principles of National Economy* (1921), ch. 38; R. T. Ely, *Outlines of Economics* (1919), ch. 24.

[4] For a survey of interest theories read Böhm-Bawerk, *Capital and Interest* (translated by William Smart), reprinted, 1922. All of the theories are summarized on pp. 78–79. His own theory is briefly stated on p. xix of the Preface and is developed in his later work, *The Positive Theory of Capital*. Alfred Marshall's criticisms of Böhm-Bawerk's doctrines should also be studied. For these see *Principles of Economics* (8th ed.), footnotes on pp. 235, 386, 528, 532, and 790.

For a recent survey of interest theories see Irving Fisher, *The Rate of Interest* (1907), chs. I–IV.

upon the distinction between two separate issues, namely, the problem of high rates of pure interest and the problem of moral usury. With regard to the first question, it is already well settled that legislative enactments can accomplish very little; in regard to the latter question, much remains to be solved. Consequently this study is relieved of such tasks as formulating new theories of interest or attempting to amend or change existing theories.

The American economist Francis A. Walker, in the light of the modern theory [1] that in primitive states of society, where prohibitions of interest originated, there may very well have been some justification for them, and that they may have had some effect, points out that there may have been a justification for statutory maximums for interest rates in some of the regions of the United States where agriculture is prosperous and where commerce and manufacturing have made some progress, yet where the community still remains mainly non-commercial.[2] He is convinced, however, that, in highly commercial countries, usury laws become purely mischievous.

In his "Political Economy" (1889) he points out that, since the rate of interest is determined by the productiveness of that last (considerable) part of the supply of capital which is applied to industry "at the greatest disadvantage," or, as other economists, having in mind short periods of time, have said, by marginal productivity,[3] usury laws can have no appreciable part in determining the rate. He answers the argument of the early legislators, that it is a hardship for persons who wish to use capital productively to be obliged to pay a high price for its use, by pointing out

[1] Alfred Marshall, *Principles of Economics* (8th ed.), book VI, ch. VI, § 2, p. 584; E. R. A. Seligman, *Principles of Economics*, ch. VIII, p. 114. See also pp. 37, 42 above.

[2] Palgrave, *Dict. Pol. Econ.*, vol. II, p. 435.

[3] F. W. Taussig, *Principles of Economics* (1921), vol. II, ch. 38, p. 17; T. N. Carver, *Principles of National Economy* (1921), ch. 39, p. 537; J. B. Clark, *Distribution of Wealth*, ch. XII; R. T. Ely, *Outlines of Economics* (1919), pp. 392–95.

that, since rates of interest become high partly because of the scarcity of capital in a community in comparison with the demand for its productive use, and since a usury law merely makes the situation worse by attempting to prevent the owners of capital from getting the full price for it, the best thing to do and the true way to cure the seeming evil is to let the price be freely paid and received, because this will attract capital from other communities where capital is more plentiful and where lower interest rates prevail. A high rate of interest freely allowed, he declares, is the best cure for the evil of a scarcity of capital.[1]

The Time-Preference Theory of Interest and its Implications

Professor Eugen von Böhm-Bawerk, of the University of Vienna, worked out some theories of usury upon the basis of his time-preference theory of interest [2] which have had a profound influence upon all recent writings on the subject. In this theory of interest the loan is considered as an exchange or sale of present valuable things against future valuable things. Present goods invariably possess a greater value than future goods of the same number and kind, and therefore a definite sum of present goods can, as a rule, only be purchased by a larger sum of future goods. Present goods command a premium in future goods. This premium is interest.[3] Interest is thus a complementary part of the price payable for a sum of present goods in future goods.[4] The paying back of the capital plus the interest constitutes a full equivalent for the sum loaned. Although interest appears as both contractual interest which is a fixed money percentage, and as natural interest which is the same amount of income received when the

[1] F. A. Walker, *Political Economy* (1889), pp. 243–44.

[2] These theories are found in *Die Positive Theorie des Kapitals*, (1888), translated under the title *The Positive Theory of Capital* (1891), by William Smart. (Reprinted 1923 by G. E. Stechert & Co., New York City.)

[3] *Capital and Interest*, p. 259. [4] *Positive Theory of Capital*, p. 296.

owner employs his own capital,[1] all kinds of interest are traced to one identical source, the increasing value of what are either naturally or economically future goods as they ripen into present goods.[2]

Böhm-Bawerk admits that, in the various forms of this exchange of present valuable things for future, the circumstances are of such a nature as to threaten the poor with exploitation by monopolists.[3] For the poor worker present goods are the necessities of life, and he must try to obtain them at any price from those who own them, either by the device of the loan, or, more usually, by selling his labor. The worker finds himself in a weak bargaining position because the capitalists who own the tools of production or who have the present goods for sale are few in number, while the proletarians who must buy are innumerable. Fortunately, strong competition usually exists between the capitalists, which tends to protect the poor from extortion. But every now and then something will happen to suspend this competition in individual cases and usury will result.[4] This may be either direct usury in the case of a consumer's loan at exorbitant rates,[5] or indirect usury in other kinds of hard bargains where inexperience and necessity are exploited.[6] He is careful to define usury, not as the making of a gain by the transaction, but as obtaining an immoder-

[1] *Capital and Interest*, pp. 8–9.

[2] *Positive Theory of Capital*, p. 358. [3] *Ibid.*, pp. 360–61.

[4] Usury here means moral usury. The word *Wucher* can never be translated as legal usury in the American sense.

[5] On this point Böhm-Bawerk says, "As a rule, the owner of present goods will be in a position of advantage, because he can do without the exchange and suffer no loss, while the borrower is often driven to pay any price for present goods. Hence the familiar cases where, in the absence of competition, usuriously high rates of 50, 100, even 200 and 300 per cent are extorted." *Positive Theory of Capital*, p. 376.

[6] One of the earliest if not the earliest of cases of implicit or indirect moral usury in this Böhm-Bawerkian sense was that of Jacob and Esau given in Genesis XXV: 27–34 (Revised Translation, Thomas Nelson & Sons, New York, 1881–1885), which reads as follows:

"And the boys grew: and Esau was a skilful hunter, a man of the field; and Jacob was a quiet man, dwelling in tents. Now Isaac [their father] loved Esau, because he did eat of his venison: and Rebekah

ately high gain.[1] He does not definitely formulate a standard by which to determine when this gain is immoderately high, but such a standard can be reasonably implied from the context. It seems clear that he has in mind the obtaining of a gain unreasonably above a fair market price.

For the sake of clearness in economic discussions there are good reasons for opposing this expansion of the concept of moral usury to include all kinds of exploitation in bargaining, but in doing this Böhm-Bawerk has performed a valuable service. This enlarged notion of social usury gives a wider view of the interrelations of the problems involved, and gives a suggestion of the wide range of difficulties to be faced by those who desire to eliminate moral usury. It is thus seen that a usury law attempting to fix loan charges is not greatly different from a minimum-wage law. The parallel between the issues involved in these two kinds of statutes will be set forth in Chapter XV.[2]

Böhm-Bawerk finally proceeds to the problem of whether interest might be abolished. He expresses the opinion, in view of the fact that the exchange of present goods for future in a loan is merely a special case of the exchange of

[their mother] loved Jacob. And Jacob boiled pottage: and Esau came in from the field, and he was faint: and Esau said to Jacob, Feed me, I pray thee, with that same red pottage; for I am faint: therefore was his name called Edom. And Jacob said, Sell me first thy birthright. And Esau said, Behold, I am about to die: and what profit shall this birthright do to me? And Jacob said, Swear to me first; and he sware unto him: and he sold his birthright unto Jacob. And Jacob gave Esau bread and pottage of lentils; and he did eat and drink, and rose up, and went his way: so Esau despised his birthright."

[1] The language of the original is as follows: "Es fällt mir nicht ein, auch solche Ausschreitungen, die wirklich eine Ausbeutung in sich schließen, unter den Schutz des günstigen Urteiles stellen zu wollen, daß ich oben über das Wesen des Zinses gefällt habe. Aber umgekehrt muß ich auch mit dem stärksten Nachdrucke betonen, das nicht schon in der Erzielung irgend eines Gewinnes aus dem Darlehen oder aus dem Arbeitskaufe die Bewucherung liegt, sondern nur in einer unangemessenen Höhe dieses Gewinnes." — Eugen von Böhm-Bawerk, *Positive Theorie des Kapitales*, Vierte Auflage (Jena, 1921), IV Buch, II Abschnitt, S. 429.

[2] See pp. 139–141 below.

goods in general,[1] that even in a socialistic state, with all private property abolished and all instruments of production vested in the community, interest would still be present because the difference in value between present goods and future goods would still exist. He remarks that it is inconceivable that present goods and future goods should be treated on the same footing in the light of man's underestimate of the future and the shortness of human life. He concludes that, even though it is conceivable that all contractual interest might be forbidden, interest would slip in if other exchange transactions between individuals were permitted.[2]

Following the lead of Böhm-Bawerk, Irving Fisher has made a very thorough analysis of the problem whether statutes can limit the market rate of interest. He points out, in view of the facts that the rate of interest depends largely upon the distribution in time of the income-stream,[3] and that borrowing and lending are not the only ways open to the individual by which the income stream can be modified because the same result can be accomplished by buying and selling property, that statutory maximums for the market rate of interest are utterly futile.[4]

Fisher also brings out a very vital point in connection with the distinction between contractual or "explicit" interest, which is the income a lender obtains by a loan contract, and natural or "implicit" interest, which is a similar income which capital returns to its owner even when it is not "loaned out at interest."

He admits that it is conceivable that, under the operation of statutes, "explicit" interest might be limited, but he declares that "implicit" interest [5] cannot be brought under

[1] *Positive Theory of Capital*, p. 375. [2] *Ibid.*, pp. 365–67.

[3] Irving Fisher, "The Rate of Interest after the War," *Annals*, American Academy of Political and Social Science, November, 1916, pp. 244–45.

[4] Irving Fisher, *Elementary Principles of Economics*, pp. 394–96.

[5] "Implicit" or natural interest does not appear to be synonymous with Marshall's quasi-rent. (Alfred Marshall, *Principles of Economics*,

the control of legislative prohibitions.[1] Interest, he says, is too omnipresent a phenomenon to be controlled by attacking any particular form; nor would any one undertake it who perceived the substance as well as the form. Although the rate of interest may appear in the form of a stipulated rate in a loan contract, in substance the rate of interest represents the terms on which the earlier and later elements of income-streams are exchangeable against each other.

Thus Fisher seems to have accomplished in a few paragraphs what it took Bentham in his rambling and disconnected way several chapters to do, namely, to show that statutory maximums are powerless to limit pure interest; and this is really all the proof necessary to show that statutory maximums should not be enacted by legislatures in an attempt to fix or limit the market rate of pure interest.

Fisher held that the rate of interest is a resultant of six different factors,[2] but that four of them are so inflexible that they have very little influence, so that for all practical purposes two alone need be considered, namely, the extent of the effective range of choice of different incomes which are open to each individual, and the factor just mentioned, the dependence of time preference upon prospective income — its size, shape, composition, and probability.

8th ed., book II, ch. IV, p. 74.) It would seem that quasi-rent is made up of the sum of both implicit interest and entrepreneur's profit assuming that the latter may be either positive, zero, or negative. This is a fair inference from the passages in Böhm-Bawerk, *Capital and Interest*, pp. 8–9.

[1] Two interesting cases illustrating the transfer of wages (which may be considered as an exchange of earlier and later elements of a worker's income-stream) may be studied in Tillotson *v.* George, 112 S.E. Rep. 896, and in Tennessee Finance Co. *v.* Thompson, 278 Fed. Rep. 597. The former was a Georgia case where a man sold his wages at a discount exceeding the lawful maximum for loan charges. The court held that the transaction was not usurious since it was a sale. In the latter case a man received $20 and gave $22 therefor, the $22 to be paid two weeks after the $20 was received. The court decided that the transaction was a loan and not a sale, and that the Finance Company was guilty of usury.

[2] Irving Fisher, *Rate of Interest*, pp. 328–29.

He also reminds us:

> If a modern business man is asked what determines the rate of interest, he may usually be expected to answer "the supply and demand of loanable money." . . . Even economists have been prone to employ "supply and demand" to describe economic causation which they could not unravel. . . . Prices, wages, rent, interest, and profits were thought to be fully "explained" by this glib phrase.
>
> It is true that every ratio of exchange is due to the resultant of causes operating on the buyer and seller and we may classify these as "demand" and "supply." But this fact does not relieve us of the necessity of examining specifically the two sets of causes, including utility in its effect on demand, and cost in its effect on supply.[1]

Theories of usury derived from both the productivity theory and the time-preference theory of interest have now been reviewed. It might be objected, since the former theory takes up only the side of demand for capital, and the latter, being but a refined abstinence theory, overemphasizes the supply side, that theories of usury derived from either of them could not be as sound as theories based upon a more complete explanation. We therefore will proceed to examine next the equilibrium theory of interest.

The Equilibrium Theory

In 1893 Professor T. N. Carver,[2] following out the idea of Alfred Marshall[3] that interest could be explained by an equilibrium theory essentially like the equilibrium theory of value, worked out the first complete theory of interest.[4] In this theory interest was found to be determined in the long run as an equilibrium resultant of the interaction of

[1] Irving Fisher, *Rate of Interest*, pp. 6–7.

[2] T. N. Carver, "The Place of Abstinence in the Theory of Interest," *Quarterly Journal of Economics*, vol. VIII, pp. 40–61.

[3] Alfred Marshall, *Principles of Economics* (8th ed.), book VI, ch. II, § 4, p. 534; book VI, ch. I, § 8; book II, ch. IV, § 8.

[4] Professor Carver later amended and refined this original theory. See his *Distribution of Wealth*, ch. VI, and *Principles of National Economy* (1921), chs. 38 and 39.

two sets of economic forces. Bringing interest under the law of value determined on the one hand by utility and on the other by cost of production, Carver explained that:

> Interest is the price that measures the marginal productivity [of capital] on the one hand and marginal cost or sacrifice on the other.

He pointed out that just as we cannot account for interest on the productivity theory alone, because with a sufficient number of increments of capital the margin will reach zero and interest will disappear, so neither can we account for interest upon a cost theory, for large quantities of capital are saved without sacrifice [1] and without expectation of interest.[2] That amount which a man would save whether there were interest or not is not saved at a cost, and there are frequent instances where future goods are preferred to present in which cases interest would be negative. Just as value would be impossible without both utility and cost, so interest would be impossible without both productivity and sacrifice costs.

Professor Taussig's statement of the equilibrium theory of interest [3] is characterized by its simplicity. It is essentially like Carver's first theory, but has certain individual refinements. It is as follows: [4]

> The several installments of savings are to be had at various rates, some for a small reward and some for a larger reward. The case is thus one of varying supply price, coming under the principle of increasing costs. [Supply curve is drawn to show some cases where costs of saving are less than zero.] . . . As we reach installments as to which the disposition to save is less and less strong, and more and more must be paid in order to induce accumulation, the line rises. Finally we reach the marginal saver. The price at which he is willing to save corresponds to the gain which is secured

[1] See Marshall, *Principles of Economics* (8th ed.), book IV, ch. VII, § 8.

[2] Carver, *Principles of National Economy* (1921), p. 543.

[3] F. W. Taussig, *Principles of Economics* (1921), vol. II, chs. 38, 39, 40.

[4] *Ibid.*, vol. II, ch. 39, § 4, pp. 27–28.

by the marginal increment of capital. Here equilibrium is reached; the rate of interest settles at a point where the marginal productivity of capital suffices to bring out the marginal installment of saving.[1]

Implications of the Equilibrium Theory

We now have before us the latest statements of the theory of interest. Laboriously built up [2] over a period of nearly four hundred years by the contributions of such men as Dumoulin, Salmasius, Galiani, Turgot, John Locke, Adam Smith, Bentham, Ricardo, Senior, Mill, and Roscher, with the finishing touches added by Böhm-Bawerk, Fisher, Marshall, Commons, Clark, Carver, and Taussig, these statements stand, for the present (1924) at least, as the final

[1] Professor Taussig's theory presents certain noteworthy characteristics:

a. He outlines the shape of the supply curve of capital in an original way by showing that it must conform to the fact that there are not only large amounts of saving without expectation of interest, but also large numbers of marginal savers, thus necessitating a moderately abrupt rise in the curve between the two nearly horizontal sections. (*Prin. Econ.*, ch. 39, § 4.)

b. He finds that interest owes its existence not only to the circumstance that production takes time, but also to the fact that, in a society of inequality of possessions, capitalists own the tools of production, thus making it possible for the owners of capital to gain from the excess of the product of labor over and above what is received by laborers. (*Prin. Econ.*, ch. 38, § 4.)

c. He points out that, although the equilibrium theory of interest is similar to the equilibrium law of value, there is a fundamental difference in that in the case of diminishing utility we deal directly with values, while in the case of diminishing productivity we deal with physical units of capital goods whose values depend upon their effectiveness in helping labor to create consumers' goods. This effectiveness, in turn, depends upon the progress of human invention and the discovery of new methods to increase the productiveness of labor. Consequently we cannot predict just in what way the increase in the use of capital in production will take place. It obeys no law. Although the rapid accumulation of capital tends continually to reduce the rate of interest, this is counteracted by the progress of inventions and improvements which give new opportunities for profitable investment. (From F. W. Taussig, "Capital, Interest, and Diminishing Returns," *Quart. Jour. Econ.*, vol. 22, pp. 361–63.)

[2] The history of the development of the theory of interest is given in Böhm-Bawerk, *Capital and Interest* (Smart's translation).

formulations. But when we examine the equilibrium theory to find what implications and corollaries can be derived from it for problems of usury, we find very little that is new. The conclusions that can be drawn from it are substantially the same as those already drawn from the productivity and the time-preference theories. Indeed, in order to prove the powerlessness of a general usury law to regulate or control the market rate of pure interest, the influence of such a statute must be examined separately in connection with each of the two sets of forces of demand and supply respectively. But such a process would be merely a repetition of work already done. If a statutory maximum for pure interest rates has been proven to be futile, reasoning from a demand theory as was done by Walker, and then again shown to be of no effect, reasoning from a supply theory as was done by Böhm-Bawerk and Irving Fisher, it seems reasonable to infer that the futility of such a statute is already established upon the basis of a complete "demand-and-supply" theory without further proof. For very short periods of time marginal productivity has full sway, while for long periods the cost of accumulating capital governs the situation regardless of legislative enactments. Each is a blade of the scissors.[1] Walker proved that usury laws cannot interfere with the operation of one blade and Fisher finally demonstrated the futility of such laws to control the other.

Nevertheless, the equilibrium theory, by thus bringing interest under the equilibrium law of value, has finally completed the demonstration that the problem of interest in its final analysis is a problem of value. "Value comes not out of the workshop where goods come into existence,

[1] The classic simile of the scissors originally appeared in Alfred Marshall, *Principles of Economics*. See the 8th edition, book v, ch. III, § 7. The passage reads: "We might as well dispute whether it is the upper or the under blade of a pair of scissors that cuts a piece of paper, as whether value is governed by utility or cost of production." [Utility or desirability is the cause of demand, while cost of production limits supply.]

but out of the wants which those goods will satisfy." [1] Thus it is pretty clear that upon the basis of either of the theories of interest [2] that have been considered, or, short-cutting all these theories as some writers have done, considering interest simply as a price determined by the law of value, it is just as absurd for legislatures to attempt to fix or limit the market rate of pure interest as it was to attempt to fix the prices of the necessaries of life.[3] The old American usury laws that still survive are therefore merely another variety of sumptuary laws and are doomed to failure like all the other uneconomic statutes that have gone before.

[1] Böhm-Bawerk, *Capital and Interest* (Smart's translation), pp. 134–35.

[2] It is misleading to attempt to place any theory of interest in a rigid category. "Some writers have laid more stress on the supply side and others on the demand side, but the difference between them has often been little more than a difference in emphasis." — Marshall, *Prin. Econ.* (8th ed.), p. 790 n.

[3] See the article on "Sumptuary Laws" in Palgrave, *Dict. Pol. Econ.*

CHAPTER X

SUMMARY AND EVALUATION

We have now arrived at what seems to be a convenient stopping-place in the approach to the problem of American usury laws. Two things have been accomplished; the canonist doctrines against the taking of interest have been overthrown; and statutory maximums for fixing or limiting the market rate of interest have been proven to be utterly futile.

Molinæus, Calvin, Salmasius, and Turgot overthrew the canonist doctrines and the famous argument of Aristotle; Turgot and Bentham showed the inexpediency of statutory maximums; Bentham proved the futility of such legal limitations to fix interest rates and listed numerous mischiefs wrought by such laws; Dana, building on the basis of foundations already prepared, constructed the most effective political speech against usury laws; F. A. Walker overthrew the argument that usury laws are necessary to lighten the hardship to borrowers of paying high interest for the productive use of capital; Irving Fisher reduced the problem of legally limiting interest to its fundamentals and presented it in its true relations based on a workable theory of interest — something which Bentham and Turgot had failed to do.

Dana's speech marks a turning-point in usury legislation in the United States. Since his time other speeches have been made, voluminous reports have been prepared, numerous petitions have been gotten up and sent to legislatures, investigations have been made, and results have been achieved. But we have the bewildering spectacle of some forty-nine jurisdictions in the United States in which the general progress in regard to usury laws for one hundred

years has been in a circle. The latest news is that California has enacted a new usury law and that New Hampshire has repealed one, and that in many of the states the scope of the usury laws is being whittled away by small-loan laws. We have enactments and repeals, more enactments and repeals, speeches and denunciations, reports and investigations, all seemingly intent on limiting the rate of interest for the benefit of society so as to prevent moral usury. But the market rate of interest continues to fluctuate up and down as it has been doing for centuries, the resultant of a set of forces over which the usury law has no perceptible control. The individual can modify his income-stream just as easily as though there were no statutory limits, and the business world continues to evade the present-day usury laws with their mild penalties with even greater facility than did the merchants in medieval times when the penalties for legal usury were severe.

Let us now outline the various valid arguments that can be advanced against the general statutory maximums known as "usury laws" which were originally enacted to regulate all kinds of charges for all kinds of loans.

The writers of the past emphasized the following:

1. A general statutory maximum is wrong in principle because it rests upon a false assumption, namely, that the expense of making all loans is the same, that it costs the lender no more in proportion to the principal to make a loan of $50 to a poor man for one month to buy clothing or pay doctor's bills than it does to lend $10,000 to a manufacturer to finance his operations.

This was advanced by Turgot.

2. A general statutory maximum is futile; it cannot limit or control the market rate of pure interest.

3. A statutory maximum is mischievous and detrimental in the field of commercial and financial relations.

These latter arguments have been used by nearly all writers on the subject. In order to prove that general statutory maximums for loan charges are inexpedient and

should not be enacted by legislatures, it is sufficient in the field of logic to establish only one of the first two points. The third point adds strength to either of the first two.

It is to Bentham's credit that he thoroughly and completely proved the second point, that usury laws intended to limit the market rate of interest are futile. He also contributed a wide range of arguments and evidence sufficient to establish the third point. But all three of these ideas are to be found fairly well handled in the writings of Turgot.

In addition to these arguments, this thesis attempts to set up another line of attack, namely:

4. A general statutory maximum for loan charges defeats its own social purpose.[1] Such a law is intended to eliminate moral usury, but it sets up a rigid definition of usury which is not at all the true definition, namely, that usury is simply taking a greater interest than the law allows, and if the maximum be fixed at some low rate such as six per cent or ten per cent, there will be numerous cases which the law will define as usurious in which there has been no true usury whatever. Moral usury is the unconscionable exploitation of a borrower's necessitous condition. It is absurd for the law to say that a loan of $5000 made at a rate of twelve per cent is usurious. No one goes out to borrow even $1000 or $500 because of extremity or necessitous circumstances. Setting up this false legal definition of usury evades the real problem and relegates it to the background. In a lawsuit the main problem is to

[1] The leading case which states the purpose of a usury law is Frorer *v.* People, 141 Ill. 171. It has been uniformly followed by courts in discussing the subject. In that case the court says:

"Usury laws proceed upon the theory that the lender and the borrower of money do not occupy toward each other the same relations of equality that parties do in contracting with each other in regard to the loan or sale of other kinds of property, and that the borrower's necessities deprive him of freedom in contracting and place him at the mercy of the lender." See p. 22n above.

See also Sou. Life. Ins. Co. *v.* Packer, 17 N.Y. 51, 53; State *v.* Griffith, 83 Conn. 1; Chapin *v.* State, 5 Oreg. 432; McArthur *v.* Schenck, 31 Wis. 673, 676.

determine if the maximum has been exceeded, not whether there was really a case of true usury.

It should be noted here, however, that Bentham was handicapped in his proof of the second point by not having a scientific theory of interest upon which to base his reasoning. Irving Fisher in a few brief paragraphs presented a much more convincing proof of the futility of usury laws to fix interest rates than Bentham in his long dissertation was able to do.

To those who have studied the subject, it seems rather strange that legislatures should enact laws which are plainly and obviously futile. Legislatures might as well pass laws that gravitation shall no longer have power over corpulent hens so as to enable them to fly; or that human beings shall no longer sink in water so as to prevent drowning.

But the strange thing about the situation is that, in spite of the fact that many authorities are agreed that the last word has been said about statutory maximums and that they are futile, mischievous, unnecessary, irrelevant, childish, etc., and that it is utterly illogical and contrary to good judgment to enact such laws, the legislators go right ahead and enact them! In 1881 it was thought that if Bentham's famous arguments could be printed and placed in the hands of the legislators at Albany, it would undoubtedly result in the repeal of the New York usury law. Accordingly a booklet was printed containing Calvin's answer to Aristotle (to convince the religious dogmatists), Dana's speech before the Massachusetts legislature, and Bentham's "Letters in Defense of Usury," and was circulated among the members of the New York legislature simultaneously with other public denunciations of the usury laws in the press. But the New York usury law, strange to say, is still unscathed, and remains to this day in the statute books as do the usury laws of forty-two other states, the District of Columbia, Alaska, and the island dependencies.

Why Legislators Enact Usury Laws and do not Repeal Them

The explanation of this situation can be found in the motives of legislators in enacting such laws. American legislators are actuated by high ideals, the overwhelming majority of them are honest, and they all want to make good on their jobs. Each of them wants to do his part in enacting laws which will remove and prevent the things which society condemns. Society exercises control over its members first by public opinion, next by custom, and finally these usages are enacted as statutes. One of these evils which public opinion has long condemned is the taking advantage by lenders of the necessitous condition and inexperience of borrowers to get them into oppressive bargains and exact from them excessive interest. This evil has been designated in this monograph moral usury. It is an evil widely prevalent in American society to-day. It is one of the things which the legislator wants to get rid of.

In the early development of American states, where capital was scarce and where there was not sufficient competition between lenders to cause competitive rates of interest, there was much moral usury. Legislators wanted to eliminate this evil and so looked around for a remedy. Naturally they would look through the statute books of the older states. Finding that New York and Pennsylvania and other important states had statutory maximums, and that such laws were the standard remedy for the evil of moral usury, the newer states copied them. In those days this was the only known remedy. True, it was often disregarded and more often broken than obeyed, but sometimes, due to fortuitous circumstances and to the lenders' ignorance of ways of evading it, the law actually did operate to prevent moral usury. The respect for law also caused the law to be obeyed by law-abiding citizens. Now and then the penalties were enforced with good moral effect. If the law worked at all, it was supposed to be better

than nothing. Before the true method of preventing typhoid fever was discovered, many doctors prescribed chewing lemons. Chewing lemons was better than no preventive at all. Having faith in the remedy was often supposed to help the situation. Enacting a usury law gave the legislators some satisfaction because it made them feel that they were making good on their jobs. Besides this, the usury laws always met with popular approval.

Most of the writers on the subject of usury laws have been content to prove their futility to fix interest rates and to show their mischievous effects, rightly thinking that these two points are enough to prove that such laws are inexpedient. But in doing this the problem of the legislator has been missed. His ideals and his point of view have been overlooked. It was settled in France in 1769 and in England in 1787 that statutory maximums could have no economic effect upon the market rate of interest, but for the United States the problem of preventing moral usury still remains. The problem to-day is a legal problem — a problem in social control. John Locke raised this issue in 1692 when he said that he favored the abolition of statutory maximums, but felt the necessity of some kind of law to prevent what this thesis defines as moral usury.

Criticism of Bentham

In evaluating the works of all these writers it is clear that the man who contributed the most to prove the futility of statutory maximums for interest rates was Jeremy Bentham. His "Letters in Defense of Usury" contain a wealth of material which establish both this point and the mischiefs of such laws. If he had had a consistent theory of interest upon which to tie his arguments his polemic would have been stronger, but that does not matter. He proved that statutory maximums are futile on the basis of any theory of interest.

But Bentham seems to have sidestepped the issue that was raised by John Locke and others.[1] He deliberately

[1] See p. 47 above. Also see pp. 53, 55.

evaded the problem of how to prevent true usury which is moral usury. He does this by a misleading juggling of words. He says: [1]

> You, my friend, by whom the true force of words is so well understood, have, I am sure, gone before me in perceiving that to say that usury is a thing to be prevented, is neither more nor less than begging the matter in question.
>
> I know of but two definitions that can possibly be given to usury; one is the taking of a greater interest than the law allows: this may be styled the *political* or legal definition. The other is the taking of a greater interest than it is usual for men to give and take; this may be styled the *moral* one, and this, where the law has not interfered, is plainly enough the only one.

Thus he thinks that he has successfully met the argument that usury should be prevented by taking the legal definition and answering that this argument begs the question. His definition of legal usury is correct, but he covers up the real problem by formulating a definition of moral usury which is only partly true. When he says that moral usury is the taking of a greater interest than is usual or customary, he does not tell the whole story. True moral usury is the taking advantage by the lender of the necessitous condition or inexperience of the borrower to get him into an oppressive bargain and thus exact excessive charges.[2]

[1] *Letters in Defense of Usury*, letter II.

[2] "Der Wucher ist vom Standpunkt der Moral nicht anders als habsüchtige Ausbeutung der Noth des Nächsten zu bestimmen." — Dr. F. X. Funk, *Zins und Wucher* (1868), S. 267–68.

"Unter Wucher versteht man nach dem gewöhnlichen Sprachgebrauche die Erhebung eines übermäßig hohen Entgeltes für die Gewährung eines Darlehens. Es wird also bei dieser Auffassung des Begriffes zunächst nur an den Geldwucher gedacht (da Darlehen in sonstigen fungiblen Gütern in der Geldwirtschaft nur von untergeordneter Bedeutung sind), und das Wesentliche an demselben ist die Uebervorteilung eines Kreditbedürftigen.

. . . . . .

"Mit der obigen Definition des Wuchers ist freilich noch keineswegs ein fest bestimmtes Merkmal zur Erkennung jedes Wucherfalles gegeben, denn der Hauptpunkt bleibt darin unbestimmt, nämlich die Entscheidung der Frage: was ist eine 'übermäßige' Vergütung für ein Darlehen. Diese Frage kann vom rein wirtschaftlichen, vom positiv-

It seems to me that this true definition of usury is found in the theory of the usury laws itself,[1] in which the courts have stated the original and ultimate purpose of such a law to be the protection of a borrower where he is not upon an equal bargaining position with the lender. The Germans have defined usury as "die Uebervorteilung eines Kreditbedürftigen" and "die habsüchtige Ausbeutung der Noth."[2]

Furthermore, there is no such thing as a usual or customary rate of interest. The charges for loans vary from time to time and with the changes in the ebb and flow of business activity. The rate of interest is always fluctuating. It also varies widely from country to country, and even in the same town it varies from day to day and with types of security. In any large city the interest rates charged vary from six per cent up to sixty per cent or more per annum.

The real argument which Bentham thus avoided might have been stated thus:

> A statutory limit for interest rates is valuable in defining usury as it does because by so doing it tends to discourage moral usury which is the thing that a usury law is designed to prevent and eliminate.

He deliberately avoided and covered up the social purpose of usury laws because he was attempting to prove the following sweeping proposition:

> That no man of ripe years and of sound mind, acting freely, and with his eyes open, ought to be hindered, with a view to his advantage, from making such bargain, in the way of obtaining money, as he thinks fit; nor (what is a necessary consequence),

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rechtlichen und vom moralischen Standpunkte aufgefaßt werden. Wirtschaftlich betrachtet würde vom Standpunkt des Schuldners dessen Belastung übermäßig erscheinen, wenn er sie voraussichtlich nicht würde tragen können, sondern dadurch seinen Ruine gegeführt würde." — Dr. Wm. Lexis, article *Wucher*, in vol. VIII, p. 963, *Handwörterbuch der Staatswissenschaften*, Dritten Auflage (1911).

[1] See footnote, p. 77 above and footnote p. 182 below.

[2] These expressions may be freely translated as "the overreaching of a needy borrower" and "the avaricious exploitation of need."

anybody hindered from supplying him, upon any terms he thinks proper to accede to.[1]

Bentham never proved this proposition as it stands, even though he proved the futility of statutory maximums and pointed out the mischiefs caused by them. Moreover, although Bentham succeeded in getting this proposition accepted and although, as a result of his "Letters in Defense of Usury," England repealed all her usury laws, subsequent experience in England and elsewhere has demonstrated that it is not safe to have no laws designed to prevent moral usury.[2]

Taussig has this to say on this point:

> Consider pawnbrokers' loans, for example. The borrowers are usually in immediate need, often timid, ignorant, and anxious for privacy. They are likely to accept hurriedly such terms as are offered at the first place where application is made. So strong is the general belief that the resulting bargains bring an undue advantage to shrewd and unscrupulous lenders, that public authority in civilized countries often regulates the transactions.[3]

Bentham not only failed to see that something is necessary to prevent moral usury, but he never thought of suggesting a remedy for the difficulty. His arguments are also weak in that he shows no understanding of the effect upon interest rates of the ebb and flow of business activity or, as we should say to-day, by the stages in the business cycle. These weaknesses in his arguments have been directly responsible for much of the confusion of thought on the subject of usury laws both in this country and in England. If Bentham had thoroughly covered all the arguments for and against usury laws, and had foreseen the difficulties and evils in the situation, and had worked out some solution for the problem of how to eliminate moral usury, there is no doubt but that the history of usury laws

[1] See p. 52 above.

[2] Samuel Williston, *Law of Contracts*, vol. III, § 1682, p. 2961.

[3] F. W. Taussig, *Principles of Economics* (1921), vol. II, ch. 40, § 1, p. 35.

both in England and in America would have been different. If Bentham had faced the question of the social purpose of a usury law, and had not quibbled on definitions of moral and legal usury, but had pointed out, as this thesis attempts to do, that a general statutory maximum fails to accomplish its social purpose because it sets up the legal definition of usury, thus making it impossible for the issue of moral usury to be raised in a usury trial, so that it becomes purely a matter of accident if a general statutory maximum prevents moral usury, he would have focused the attention of legislators both in England and America upon their real problem in regard to the situation and might have hastened its solution.

The Goal of this Thesis

The historical approach to the problem of American usury laws is now as complete as seems necessary for the purposes under consideration. Three of the four questions involved in the problem have now been answered, namely:

(1) What is the general economic and social-legal situation in which the problem of usury arises?
(2) What is the present status of usury laws in the United States? and
(3) What conclusions can be drawn from a critical study of the arguments already advanced, for and against usury laws?

It can now be seen that the reason for stating the main problem in three ways in Chapter I was primarily because of the historical development of the question. The theorists were satisfied when they were convinced some years ago that the usury laws are futile and mischievous. But logical proof, however perfect, does not satisfy the business man. He impatiently asks:

How can the business world get rid of these futile and mischievous laws *now?*

But only the legislatures have the power to repeal the usury laws. The business world cannot get them repealed

until the legislator's problem is solved. Proving that the laws are futile and mischievous is not sufficient to move the legislator. To convince him, another line of argument is necessary. For him the social purpose of a law is everything. He probably figures that, if the usury law only deters a few lenders from charging high rates, it is justified. The legislators will continue to keep on the books these laws, which they know to be futile and mischievous, because such laws are the only remedy they know of for the evils that they want to see eliminated from commercial society. The legislators will be satisfied to repeal the laws only when they are shown that there is a better instrument for carrying out their social purpose, namely, to prevent and eliminate moral usury.

The problem of the business man thus becomes in its final analysis the problem of the legislator, and all the three different points of view in approaching the problem of usury laws become merged in one larger point of view, the point of view of economic society in general.

PART THREE

RECENT DEVELOPMENTS IN THE PROBLEM OF USURY LAWS AND CONCLUSIONS

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CHAPTER XI

RECENT LEGISLATIVE ENACTMENTS IN CALIFORNIA AND IN NEW HAMPSHIRE

We may now skip over the hundreds of legislative enactments in the various states that have taken place since Dana's time, and consider the two most important recent events in the history of usury laws, namely, the enactment of a new usury law in California in 1918 and the repeal of the New Hampshire usury law in 1921.

California's New Law

From the time of its admission to the Union in 1850 California had never had a usury law, and up to 1918 stood unique among all the states in this respect in spite of the fact that at different periods attempts had been made to enact statutory maximums for interest rates for all loans. In 1909 there had been passed a law, later amended in 1911, for the regulation of small loans of the consumptive class, which allowed a maximum of two per cent a month on that class of loan.

In 1918 many people in California began to think that something must be done to stop the rise in interest rates that was taking place along with the rise in commodity prices. So the new bill fixing a maximum of twelve per cent for all kinds of loans was introduced. Incidentally the bill was so worded as to have the effect of repealing the small-loan law of 1909.

A unique feature of this legislation was that the law was

BALANCING OF FACTORS FOR AND AGAINST THE CALIFORNIA USURY LAW[1]

FAVORABLE	UNFAVORABLE
1. This law will regulate interest rates and prevent money-lenders from taking advantage of borrowers. It will protect the poor man who cannot afford to pay high rates.	1. Governor Hiram Johnson, after a thorough investigation, vetoed a similar bill.
2. The Government can borrow money at four per cent per annum. The people ought not to have to pay high rates.	2. The law will be evaded and will therefore be futile.
3. The law is made effective by severe penalties.	3. Many of the eastern states have tried this kind of law and abandoned it after finding it did not work.
4. Nearly every state now has a usury law. Therefore California ought to have one.	4. This law will repeal the small-loan law of 1909 and will drive legitimate money-lenders from the field. No legitimate money-lender can stay in business under this law.
5. California is the Mecca of the loan sharks. They are breaking the small-loan law of 1909 with its twenty-four per cent maximum and they charge fees and commissions in addition so that they get from five per cent to twelve per cent a month instead of the maximum of two per cent per month. The passage of this law will punish them and will not let them get over one per cent per month.	5. The legitimate money-lender being driven out will leave the field to the "loan sharks" who will charge higher rates than ever.
6. This law will not drive capital from the state. Twelve per cent is enough interest for any kind of loan.	6. If you want to take a good swat at the loan shark, vote "no."
	7. The law will stifle many business enterprises and will drive capital from the state.

[1] From Amendments to Constitution and Proposed Statutes with Arguments Respecting the Same, to be Submitted to the Electors of the State of California at the General Election on Tuesday, November 5, 1918. Issued by Frank C. Jordan, Secretary of State, September 23, 1918.

submitted to the people of the state at the general election November 5, 1918, according to California usage. To guide the people of the state in voting on the law an attempt was made to give a brief summary of the arguments both favorable and unfavorable to the law. The law was passed on the basis of the clash of argument shown on page 90.

In 1919, finding that it was necessary to have a higher maximum for small loans, California passed a law permitting one per cent a month interest for this class of loans with fees also permitted of five per cent.

New Hampshire Repeals her Usury Law[1]

In 1921 New Hampshire had the distinction of having the oldest usury law in the country as its law had remained unaltered on the statute books since 1791, a period of one hundred and thirty years. It should be mentioned, however, that in 1917 a small-loan law[2] had been enacted which fixed a maximum of three per cent per month for that class of loan.

During the 1921 session of the New Hampshire legislature the agricultural interests held the balance of power and carefully examined each bill that came up to determine its possible advantage or disadvantage to them. This was but a local manifestation of the agrarian movement which is now (1924) being felt in nearly all of the states and particularly in Congress.

The bill repealing the limitations on interest rates was introduced into the House of Representatives early in the session. It was referred to the Judiciary Committee, who were originally about evenly divided in regard to its merits, but after several hearings the committee reported unani-

[1] The material on the repeal of the New Hampshire usury law is taken from letters to the author from Mr. G. K. Richardson, of Boston, and from Mr. W. W. Thayer, and Mr. William N. Rogers, of Concord, New Hampshire.

[2] Laws governing pawnbrokers had been enacted in 1907.

mously in favor of the bill. The committee's report was adopted by the House without discussion, and the bill then went to the Senate. The Senate committee to whom it was referred also had several hearings upon it and brought in a divided report. The Senate passed the bill by a vote of 12 to 11, and the Governor then signed it. Immediately afterwards, in the closing days of the session, an attempt was made to reëstablish the old law, but without success.

Some of the bankers of the State were anxious to have the law repealed. They felt that, during the recent period of high interest rates, the banks of New Hampshire had been at a disadvantage in competition with Massachusetts banks which were not subject to any statutory maximum for interest rates. The maximum in New Hampshire was six per cent with a penalty of a forfeiture of three times the excess interest for violations. As a result of this situation the following things were happening:[1]

1. A considerable amount of New Hampshire money, instead of being loaned in New Hampshire, was being sent to Massachusetts and to other states where the lawful rates were higher.

2. Many law-abiding bankers and money-lenders were getting less than the real market value for lending money in the state.

3. There were numerous instances of evasions of the usury law by means of all the various devices which have been in vogue for years.

4. Some lenders of money withdrew it from those who were borrowing and invested it in United States Government bonds. These bonds, purchased at current market rates, not only paid a better return than the lawful rate permitted in New Hampshire, but were less risky and were tax exempt up to certain limits.

5. Many cities, towns, and counties in New Hampshire that wanted to borrow money for improvements could not

[1] From letter of G. K. Richardson, August 8, 1921.

BALANCING OF FACTORS FOR AND AGAINST THE NEW HAMPSHIRE USURY LAW

Favorable	Unfavorable
1. It was a settled policy of this state to limit interest rates to six per cent. This limit had always been high enough in the past.	1. As the Boston Federal Reserve Bank was at the time charging six and one-half per cent on rediscounts, it seemed unreasonable to require New Hampshire banks to loan at six per cent.
2. The existing high market rate for money was a temporary one for which special legislation was unnecessary.	2. As there was no difficulty in New Hampshire banks sending their money outside the state and getting seven to eight per cent thereby, there seemed some danger that the six per cent limitation would deprive New Hampshire people of desirable capital.
3. The repeal of the maximum would permit bankers to charge any rate they wanted to. This would make it hard on the farmers.	3. The neighboring states of Maine and Massachusetts had no statutory maximums on interest rates.
	4. Large borrowers were being compelled to go outside the state to get money.
	5. If these borrowers went to Boston banks, the banks often insisted on their opening an account there to the detriment of New Hampshire banks.
	6. The State of New Hampshire and New Hampshire cities, towns, and counties were borrowing outside the state at more than six per cent.
	7. To invest in United States bonds at market rates would yield more than six per cent with added safety of principal and tax exemptions.
	8. There had been passed early in the session of 1921 a special act permitting public utilities to issue bonds at greater rates than six per cent. This was a discrimination against manufacturing corporations.

borrow in New Hampshire, but were compelled to go outside the state to get funds. Even if these cities, towns, and counties were willing to pay the market rates for money, which was considerably above six per cent, the banks and other lenders disliked to lend to them at unlawful rates.

So, in order to get the law repealed, the needs of the farmers were emphasized. The agricultural interests wanted better roads. In order to get better roads the counties would have to borrow money. To get money in New Hampshire on the most favorable terms the usury law would have to be repealed. This line of argument accomplished the desired object.

The clash of argument upon the basis of which New Hampshire repealed her usury law is shown on page 93.

The repeal of the usury law provoked more comment and criticism throughout the state than did any other action of the 1921 session. As a result of the act, many charges were made, particularly by members of the grange and allied farmer interests, to the effect that the inception, growth, and culmination of the repeal were reflected in the banking interests of the state.

Since the repeal of the usury law, there has been no change in the status of affairs as regards interest rates in New Hampshire. Consistently with the recent tendency of the market rate of interest to fall, the banks of New Hampshire still continue to lend at rates of six per cent, or even less, in spite of the fears that they would combine to raise their rates.

One cannot help but be impressed by a comparison of the California and the New Hampshire legislative enactments. In neither case did any scientific economic theory of interest come up for consideration. The California problem was decided on the basis of camouflaged arguments and confused ideas on both sides. The real issues were never discussed. The New Hampshire decision, however, was based on a practical business problem and the arguments were pertinent to the situation, but even there the usury

law was repealed on the basis of expediency rather than a scientific understanding of the phenomenon of interest and of the social problem of moral usury.

CHAPTER XII

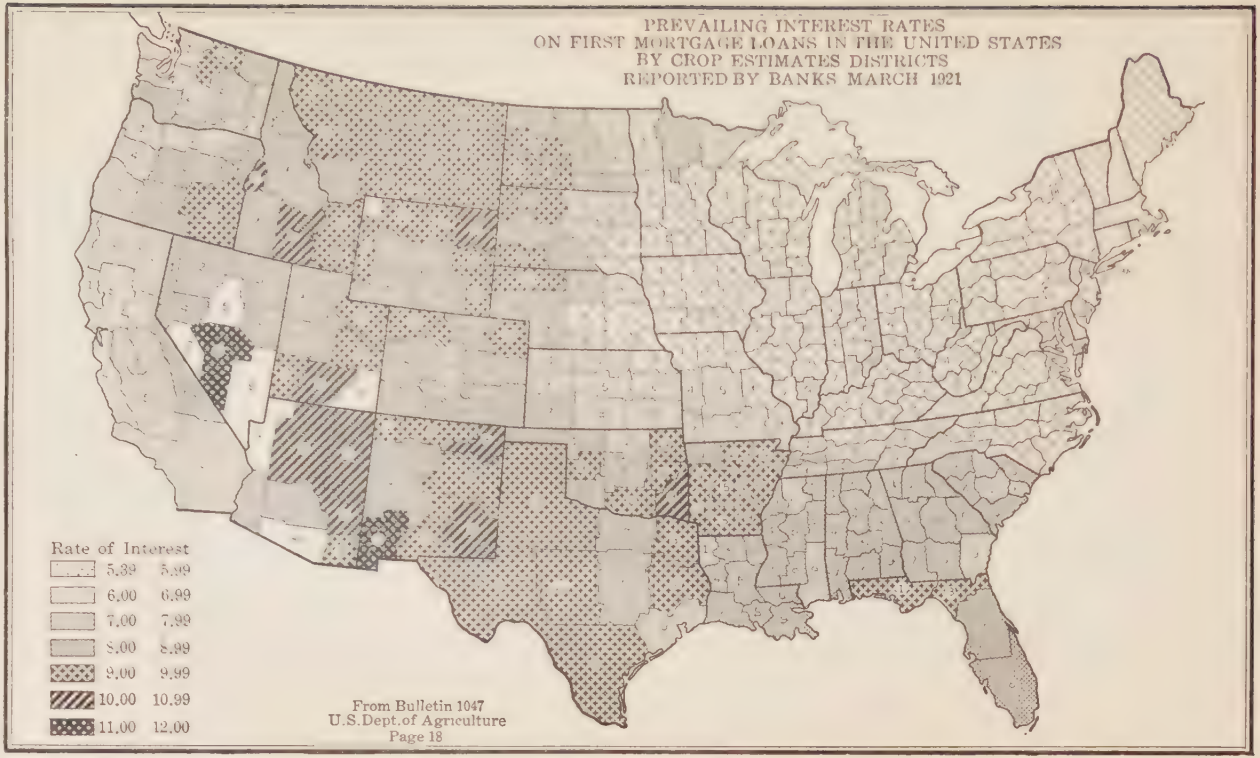
HOW THE USURY LAWS HAVE OPERATED IN THE FIELD OF AGRICULTURAL LOANS

THE farmers in the agricultural sections of the United States, for many years, have been striving to get lower interest rates upon farm loans. They think they should be able to borrow capital upon as favorable terms as are ordinarily granted to large manufacturers and commercial concerns. This has been a large factor in keeping the usury laws upon the statute books of the different states. It will therefore be interesting to study a map of the United States to see the relations between the statutory maximums and the actual interest rates reported by bankers.

In Bulletin 1047 of the Department of Agriculture there is a study of actual interest charges by bankers on mortgage loans, prepared under the direction of Mr. V. N. Valgren, Agricultural Economist. In this bulletin is a map showing actual interest rates.[1] We can compare this map with the map of the statutory maximums of the usury laws.[2] In Plate III the data are combined in one map. It will be valuable to study these figures in three ways: (a) by comparing the actual rates between states having equal statutory maximums, (b) by comparing the actual rates of states with different maximums, and (c) by contrasting the situation in states with usury laws with the situation in states having no usury laws.

The bulletin includes data on both first mortgages and second mortgages, but since the second mortgage business is so much less in volume than the former, and since first mortgage procedure is better standardized, we shall not

[1] See Plate II of this monograph. [2] See Plate I above.


PREVAILING INTEREST RATES
ON FIRST MORTGAGE LOANS IN THE UNITED STATES
BY CROP ESTIMATES DISTRICTS
REPORTED BY BANKS MARCH 1921
Rate of Interest
5.39 5.99
6.00 6.99
7.00 7.99
8.00 8.99
9.00 9.99
10.00 10.99
11.00 12.00
From Bulletin 1047
U.S. Dept. of Agriculture
Page 18

study the second mortgage figures.[1] Our study will then be limited to bank agricultural loans on first mortgages.

In this study by the Department of Agriculture, questionnaires were sent out to banks in all the states. The so-called "prevailing rate" reported in the bulletin is an arithmetic mean computed from rates reported by the bankers, and, of course, is not as good an average to use in this study as a mode of these rates would have been, since the arithmetic average will be more affected by refusal of banks to report than would a mode. Nevertheless, for this purpose, the arithmetic average, although it represents in most cases a rate never actually charged upon any loan (such as 5.26 per cent or 8.56 per cent), is useful and gives an appearance of exactness which has some significance. It possesses the merit of being readily understood by business men and legislators who care little for refined statistical averages.

In order to present the data in the most convenient form the states will be rearranged in tables conforming to the statutory maximums for interest rates set by the usury laws.

One outstanding feature of the situation is the great variety in the statutory maximums for interest rates in the different jurisdictions. The states may, however, be grouped according to their usury laws in 1921 as follows:

GROUP A (*six per cent maximums*)

This is a group of eleven states all forming one compact area. They are: Vermont, New York, New Jersey, Delaware, Pennsylvania, Maryland, Virginia, West Virginia, North Carolina, Kentucky, and Tennessee.

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[1] Another reason for omitting a consideration of the second mortgage figures is that they come from too few bankers. In Bulletin 1047 the inadequacy is shown by the fact that there are thirty-two cases where lower prevailing rates are shown for second mortgages than for first mortgages, because of the fact that in some areas, with high first mortgage rates, no rates are reported for second mortgages. This makes the two rates incomparable. For instance, the prevailing rates for first mortgage loans in Virginia and Nevada are shown to be higher than the prevailing rates for second mortgage loans in those states.

USURY LAWS AND PREVAILING INTEREST RATES FOR FIRST MORTGAGE FARM LOANS BY BANKS[1]

Name of State	Number of Banks Reporting	State Prevailing Rate[2]	State Typical "High" Reported Rate	Highest District Prevailing Rate[3]
STATES HAVING SIX PER CENT MAXIMUMS				
New Hampshire[4]	28	5.39	5.66	5.66
Vermont	33	6.05	6.32	6.32
New York	215	5.94	5.96	6.00
New Jersey	35	6.00	6.00	6.00
Pennsylvania	236	5.97	6.00	6.06
Delaware	12	6.00	6.00	6.00
Maryland	50	6.00	6.00	6.00
Virginia	110	6.17	6.26	7.29
West Virginia	51	6.06	6.16	6.75
North Carolina	99	6.12	6.31	8.00
Kentucky	134	6.45	6.72	8.00
Tennessee	171	7.51	7.85	8.82
STATES HAVING SEVEN PER CENT MAXIMUMS				
Michigan	254	6.62	6.84	7.00
Illinois	462	6.32	6.57	7.11
STATES HAVING EIGHT PER CENT MAXIMUMS				
Ohio	352	6.40	6.85	6.92
Indiana	370	6.56	7.01	7.12
Iowa	442	6.44	6.85	7.13
Missouri	408	7.13	7.47	8.05
South Carolina	176	7.98	8.01	8.07
Georgia	241	8.28	8.56	9.04
Alabama	149	8.18	8.40	9.00
Mississippi	154	7.99	8.06	8.15
Louisiana	48	8.24	8.63	9.20

[1] Data from V. N. Valgren, *Farm Mortgage Loans*, Bul. 1047, U.S. Department of Agriculture.

[2] The prevailing rate is the arithmetic average of rates reported.

[3] Each state was divided into districts, except some of the smaller states. The "high" rate is an average of "prevailing high rates" reported in the state. The highest district prevailing rate is also given.

[4] The New Hampshire usury law was repealed after these data were compiled.

USURY LAWS AND PREVAILING INTEREST RATES FOR FIRST MORTGAGE FARM LOANS BY BANKS[1] (*continued*)

Name of State	Number of Banks Reporting	State Prevailing Rate[2]	State Typical "High" Reported Rate	Highest District Prevailing Rate[3]
STATES HAVING TEN PER CENT MAXIMUMS				
Wisconsin	378	6.32	6.70	7.34
Minnesota	520	6.86	7.38	8.71
North Dakota	335	8.35	8.86	9.86
Idaho	71	8.83	9.32	10.00
Oregon	112	7.96	8.27	10.00
Arizona	21	9.00	9.62	10.00
Nebraska	298	7.19	7.78	9.79
Kansas	382	7.30	7.76	9.36
Oklahoma	185	8.98	9.37	10.00
Texas	223	9.05	9.35	10.00
Arkansas	125	9.34	9.70	10.00
Florida	46	8.59	8.96	9.75
STATES HAVING TWELVE PER CENT MAXIMUMS				
Connecticut	39	5.99	6.01	6.01
South Dakota	230	7.55	8.13	10.12
Montana	169	9.50	9.81	10.00
Washington	124	7.95	8.34	9.71
Wyoming	55	9.21	9.85	10.00
Utah	41	8.71	9.46	10.00
California	277	7.20	7.54	9.00
New Mexico	33	9.52	9.88	11.00
STATES HAVING NO MAXIMUMS[4]				
Maine	38	6.32	6.42	6.42
Massachusetts	67	5.98	6.10	6.20
Rhode Island[4]	5	6.00	6.00	6.00
Colorado	121	8.58	9.06	10.00
Nevada	8	8.62	8.75	12.00

[1] Data from V. N. Valgren, *Farm Mortgage Loans*, Bul. 1047, U.S. Department of Agriculture.

[2] The prevailing rate is the arithmetic average of rates reported.

[3] Each state was divided into districts, except some of the smaller states. The "high" rate is an average of "prevailing high rates" reported in the state. The highest district prevailing rate is also given.

[4] The Rhode Island maximum of thirty per cent may be considered no limit.

GROUP B^1 (*seven or eight per cent maximums*)

Illinois (seven per cent) is the geographical center of a group of six states which have either seven or eight per cent maximums. The other five states are: Michigan (seven per cent), Ohio (eight per cent), Indiana (eight per cent), Missouri (eight per cent), and Iowa (eight per cent).

GROUP B^1 (*eight per cent maximums*)

Alabama is the center of a compact group of five states with eight per cent maximums. The other states are South Carolina, Georgia, Mississippi, and Louisiana.

GROUP C (*ten per cent maximums*)

Group C is a widely dispersed group with Kansas as its geographical center. This group includes Florida, Arkansas, Texas, Oklahoma, Kansas, Nebraska, Wisconsin, Minnesota, North Dakota, Arizona, Idaho, and Oregon.

GROUP D (*twelve per cent maximums*)

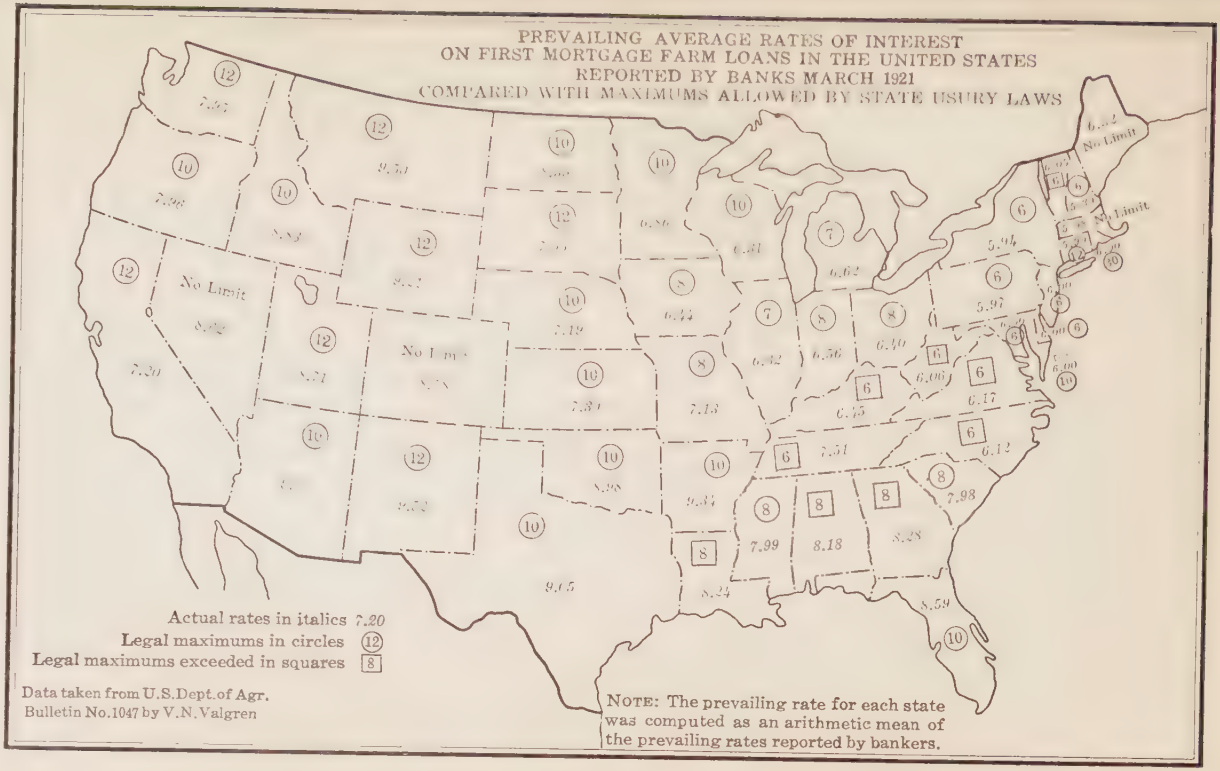
Group D is a dispersed group of seven states, all of which have statutory maximums of twelve per cent. They are South Dakota, New Mexico, Montana, Utah, Wyoming, Washington, and California. Utah is the geographical center. These states are all in the western half of the United States.

GROUP E (*no statutory maximums*)

The states of Massachusetts, New Hampshire, and Maine have no usury laws in the field of commercial and investment loans. Rhode Island has such a high maximum (thirty) per cent that it virtually operates as no limit. Connecticut with a maximum of twelve per cent has such a mild penalty for usury that it may be ignored.

From the statistical data here shown, it would appear that some states "enforce" their usury laws and that some do not. Thus, in the six per cent area, it looks as though New Hampshire, New York, New Jersey, Pennsylvania, Delaware, and Maryland have been successful in keeping down interest rates by the usury laws. Yet we know that in New York the prevailing time-money rates in the years 1920–21 were as high as eight per cent,[1] and that on mortgage loans there were frequent evasions, as noted in the

[1] See *Federal Reserve Bulletins* for those years.


PREVAILING AVERAGE RATES OF INTEREST
ON FIRST MORTGAGE FARM LOANS IN THE UNITED STATES
REPORTED BY BANKS MARCH 1921
COMPARED WITH MAXIMUMS ALLOWED BY STATE USURY LAWS
No Limit
No Limit
No Limit
No Limit
Actual rates in italics 7.20
Legal maximums in circles (12)
Legal maximums exceeded in squares [8]
Data taken from U.S.Dept.of Agr.
Bulletin No.1047 by V.N.Valgren
NOTE: The prevailing rate for each state was computed as an arithmetic mean of the prevailing rates reported by bankers.

following chapter. It is clear, therefore, that in some states bankers have made out their notes to show contract rates within the usury law limit and yet have evaded the law in other ways. This invalidates much of the material where it appears that the usury laws have been strictly enforced.

Let us note the five states which have no usury laws and where the bankers were free to report approximately actual conditions. These are Maine, Massachusetts, Rhode Island, Colorado, and Nevada. We find from the returns from those states that interest rates in them were not greatly different from those in similar states with usury laws. Colorado with no penalty for usury has a somewhat lower rate than Wyoming with a twelve per cent maximum. Massachusetts with no usury law has about the same rate as New York with its strict six per cent maximum. The Massachusetts rate is, indeed, somewhat lower than the actual rates in Vermont which has a six per cent maximum.

It is particularly interesting to note that in the five southern states, South Carolina, Georgia, Alabama, Louisiana, and Mississippi, all with eight per cent maximums and all in one area, the usury laws are apparently not very well enforced, for the bankers have not hesitated to report contract rates above the eight per cent limit. But the four northern states having eight per cent maximums, Ohio, Indiana, Iowa, and Missouri, seem to have "well-enforced" usury laws, to judge by the returns.

Yet we know well enough that a usury law has very little effect upon rates to be charged by lenders in such circumstances, because it is so easy to evade the law. If the law is strict, the contract rate can be made to conform to the statute, but people will evade the law in other ways. The reasoning of Turgot, Bentham, Dana, and Irving Fisher is incontrovertible.

Compare North Dakota with its ten per cent maximum with South Dakota with its twelve per cent maximum. We find that the prevailing rate in South Dakota[1] is 7.55

[1] South Dakota has a well-developed state rural credit system.

per cent, and lower than the prevailing rate of 8.35 per cent in North Dakota. Compare Wisconsin with its ten per cent legal maximum with Illinois having a seven per cent maximum. Wisconsin's prevailing rate of actual interest charges is 6.31 per cent, and that of Illinois is 6.32 per cent, practically the same. The three points extra margin in Wisconsin has had no effect upon the situation. Michigan with its seven per cent maximum has a prevailing rate of 6.62 per cent which is actually higher than the rates in the neighboring states of Wisconsin and Illinois. Michigan's prevailing rate is also higher than the rates in Iowa, Ohio, and Indiana, which have eight per cent legal maximums.

California, which had no usury law until 1918, now has a twelve per cent maximum. This law appears to be "well enforced" from the returns given. Yet California's prevailing rate of 7.20 per cent is a full point or more above the prevailing rates of the New England states having no usury laws.

It is noteworthy that the prevailing rates of Vermont (6.05), Virginia (6.17), West Virginia (6.06), North Carolina (6.12), Kentucky (6.45), Tennessee (7.51), Georgia (8.28), Alabama (8.18), Louisiana (8.24) are all higher than the usury laws of those states allow and all higher than the prevailing rate in Massachusetts which has no general usury law.

Colorado's prevailing rate of 8.58 per cent and Nevada's prevailing rate of 8.62 per cent are lower than the prevailing rates in such states having usury laws as Arizona, Idaho, Oklahoma, Texas, Arkansas, Montana, Wyoming, Utah, and New Mexico. Colorado, with no penalty for usury, is nearly surrounded by the usury-law states, Wyoming, Utah, Arizona, Texas, and Oklahoma, and yet has lower prevailing interest rates on first mortgage farm loans, according to the government returns, than those states.

In carrying on the research work of preparing Bulletin 1047, no attention was given by the writers to usury laws. It seems very evident that the prevailing rates that were

worked out were very little influenced by usury laws, except in the cases noted where banks must resort to the various devices used to evade the usury laws.

There is another situation which merits considerable attention. This is seen by a comparison between North Carolina and South Carolina. North Carolina has a statutory maximum of six per cent, while South Carolina has a maximum of eight per cent. The bulletin shows that the prevailing rate for loans on first mortgage farm loans by banks in North Carolina is but 6.12 per cent, while in South Carolina it is 7.98 per cent. Both rates are very close to the usury law maximums. Here the advocates of usury laws as effective devices to keep down interest rates may find some basis for their contentions. To those who have only this bulletin (1047), there seems to be no explanation.

The explanation for the situation is to be found in an earlier bulletin (409), prepared by Mr. C. W. Thompson in 1916. This bulletin took up the problem of interest rates on loans to farmers on personal security. The material in this bulletin is summarized in the accompanying table and bar chart. (Plate IV.)

Compare North Carolina and South Carolina on this table and chart. We find the average rate of interest in North Carolina was 6.6 per cent, while in South Carolina it was 8.3 per cent. Mr. Thompson also noticed this situation. But he found the explanation in the figures for the "average total cost." He found that average total cost including "discounts, bonuses, commissions, and any other extra charges" was 10.2 per cent for North Carolina for this type of loans and 10.5 per cent for South Carolina. The report says:[1]

> The relatively large figure shown for extra cost in North Carolina is due, in part, to the fact that with a legal interest rate of six per cent the lenders of that state have made up in extra charges what the state law does not permit them to charge as interest.

[1] C. W. Thompson, Bulletin 409, U.S. Department of Agriculture, pp. 1–2.

USURY LAWS AND PREVAILING INTEREST RATES

For Loans to Farmers on Personal Security[1] in 1916

Name of State	Usury Law Maximum	Average Rate of Interest	Average[2] Total Cost	Excess of Total Cost over Legal Maximum
Maine	No limit	6.5	7.7	0.4
New Hampshire[3]	6	6.0	6.4	0.4
Vermont	6	5.9	6.4	0.4
Massachusetts	No limit	6.0	6.5	..
Rhode Island	30	6.1	7.1	..
Connecticut	12	5.9	6.2	..
New York	6	5.9	7.0	1.0
New Jersey	6	5.8	6.6	0.6
Pennsylvania	6	5.9	6.9	0.9
Ohio	8	6.4	7.2	..
Indiana	8	6.9	7.6	..
Illinois	7	6.6	7.4	0.4
Michigan	7	7.1	9.2	2.2
Wisconsin	10	6.5	7.0	..
Minnesota	10	8.3	9.2	..
Iowa	8	7.5	7.9	..
Missouri	8	7.7	8.8	0.8
North Dakota	10	11.0	11.8	1.8
South Dakota	12	9.8	10.6	..
Nebraska	10	8.8	9.3	..
Kansas	10	7.5	8.8	..
Delaware	6	6.0	6.2	0.2
Maryland	6	6.0	7.0	1.0
Virginia	6	6.3	8.2	2.2
West Virginia	6	6.2	6.6	..

[1] C. W. Thompson, Bulletin 409, U.S. Department of Agriculture, 1916. This bulletin is a study of the data received from questionnaires sent out to banks in 1916.

[2] Average of estimated total costs (rate per cent), including "discounts, bonuses, commissions, and any other extra charges," as reported by correspondents.

[3] California had no usury law in 1916. The California usury law was enacted in 1918. On the other hand, New Hampshire had a usury law at that time which was repealed in 1921.

USURY LAWS AND PREVAILING INTEREST RATES

FOR LOANS TO FARMERS ON PERSONAL SECURITY[1] IN 1916 (*continued*)

NAME OF STATE	USURY LAW MAXIMUM	AVERAGE RATE OF INTEREST	AVERAGE[2] TOTAL COST	EXCESS OF TOTAL COST OVER LEGAL MAXIMUM
North Carolina	6	6.6	10.2	4.2
South Carolina	8	8.3	10.5	2.5
Georgia	8	9.6	11.8	3.8
Florida	10	9.2	11.4	1.4
Kentucky	6	7.3	8.8	2.8
Tennessee	6	8.1	9.9	3.9
Alabama	8	10.0	12.4	4.4
Mississippi	8	8.7	10.8	2.8
Arkansas	10	9.9	12.4	2.4
Louisiana	8	9.0	11.1	3.1
Oklahoma	10	12.5	15.6	5.6
Texas	10	10.2	12.2	2.2
Montana	12	11.1	12.1	0.1
Idaho	10	10.4	11.5	1.5
Wyoming	12	10.2	11.0	..
Colorado	No limit	10.6	11.5	..
New Mexico	12	11.4	13.8	1.8
Arizona	10	10.0	11.1	1.1
Utah	12	8.8	10.4	..
Nevada	No limit	..	..	..
Washington	12	9.8	11.4	..
Oregon	10	8.4	9.6	..
California	No limit[3]	8.4	9.4	..

[1] C. W. Thompson, Bulletin 499, U.S. Department of Agriculture, 1916. This bulletin is a study of the data received from questionnaires sent out to banks in 1916.

[2] Average of estimated total costs (rate per cent), including "discounts, bonuses, commissions, and any other extra charges," as reported by correspondents.

[3] California had no usury law in 1916. The California usury law was enacted in 1918. On the other hand, New Hampshire had a usury law at that time which was repealed in 1921.

The table and bar chart show that there are extra charges in addition to the contract rates of interest in all of the states, and that the usury laws have very little effect upon the rates of interest on this type of loan.

Minimum Balance Requirements for Bank Loans to Farmers on Personal and Collateral Security

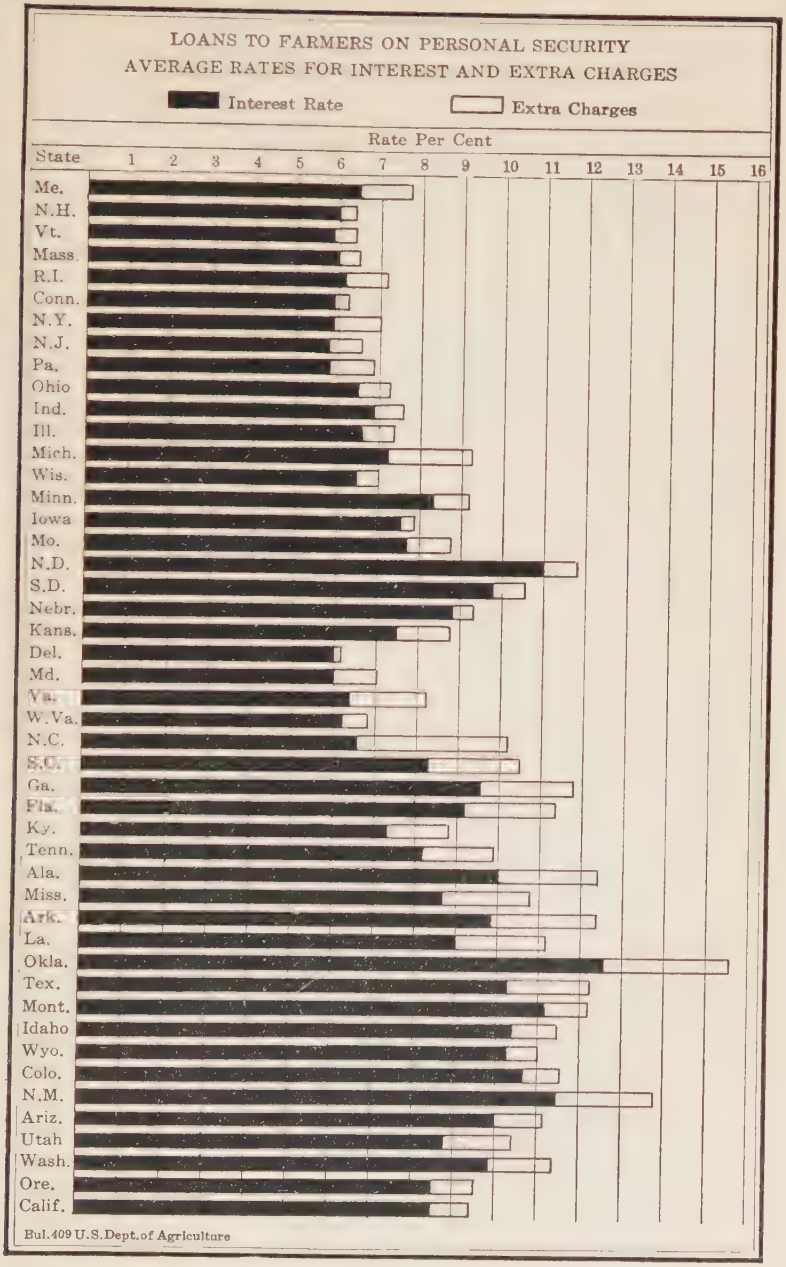
There is another way in which the total cost to farmers for these personal loans is still further increased. Some rural banks require that a certain portion of the loan be kept permanently on deposit as long as the loan exists. This has the effect of making the loan actually extended smaller than the face of the note upon which interest is based.[1] A considerable number of rural banks enforce this requirement in a manner similar to that of the large commercial banks. On this point, Mr. Valgren remarks:

> It seems probable that these practices have resulted from the mistake of establishing by law a maximum rate of interest which is lower than is justified by the available supply of capital in relation to demand. Under such circumstances, creditors are tempted to resort to evasions, the effects of which may not comprehend and which in many instances no doubt bring the actual cost above what it would be if the laws were so drawn as merely to prevent actual extortion without attempting to regulate the rate in a free and open market.

In these tables and maps and bar chart is seen the working out of the economic principles as formulated by Irving Fisher. Usury laws simply do not operate. A statute cannot control the market rate for productive loans. All the data submitted show that these general blanket statutory maximums for all kinds of charges for all kinds of loans are not only powerless but mischievous. But the problem still remains. The farmer wants lower interest rates.

But the securing of lower interest rates for farmers must come in a different way from that of artificially controlling

[1] V. N. Valgren, Bulletin 1048, U.S. Department of Agriculture, p. 17.


LOANS TO FARMERS ON PERSONAL SECURITY
AVERAGE RATES FOR INTEREST AND EXTRA CHARGES
Interest Rate
Extra Charges
Rate Per Cent
State
1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16
Me.
N.H.
Vt.
Mass.
R.I.
Conn.
N.Y.
N.J.
Pa.
Ohio
Ind.
Ill.
Mich.
Wis.
Minn.
Iowa
Mo.
N.D.
S.D.
Nebr.
Kans.
Del.
Md.
Va.
W.Va.
N.C.
S.C.
Ga.
Fla.
Ky.
Tenn.
Ala.
Miss.
Ark.
La.
Okla.
Tex.
Mont.
Idaho
Wyo.
Colo.
N.M.
Ariz.
Utah
Wash.
Ore.
Calif.
Bul.409 U.S.Dept.of Agriculture

interest rates by statute. Progress is already being made. The farmers' problem along this line is on its way to a solution in this country in a somewhat similar manner to that followed in France and Germany. When steps are taken that will effectually reduce the losses on bad loans by rural bankers, their loan charges will automatically come down. The National Farm Loan Associations now being formed all over the United States, patterned after the European systems, are helping in this direction. These associations and other rural credit unions operate to knit the farm community together in an economic community of interests. It thus becomes to each other's interest to promote the managerial ability and prosperity of the group. This cuts down losses, promotes credit standing, and attracts capital from the outside, which inevitably cause interest rates to come down.

The Federal Land Bank system is an ingenious device to promote the movement of capital into agricultural loans. Each Federal Land Bank bond is the obligation of the entire system, and each loan made as a basis of the bonds is subjected to a set of strict standards before it is approved. This operates to even up the differences in agricultural interest rates shown in the accompanying interest maps.

The exempting of Federal Land Bank bonds and Joint Stock Land Bank bonds from income taxes is an additional effective method by which interest rates are being cut down for the farmer. This, in reality, is subsidizing the farmer. By this system he is enabled to borrow at lower rates because of the low rates at which the bonds sell. But the taxes which the bondholders escape paying by this method must be paid by other taxpayers, mostly in the industrial sections of the country, who thus pay extra taxes in order that the farmer may borrow at lower rates.

I do not think that this method of getting lower rates of interest for farmers is socially justifiable, but it is certainly more effective in cutting interest rates than any usury law could ever be. The best measures that are being taken are

along the lines of pooling the credit standing of the community and building up the economic solidarity of the farm neighborhood. If the results obtained by this method in European countries can be gotten here, it will not be many years until interest rates will be much lower in the agricultural sections of the south and west.

It will be to the advantage of rural bankers to help in this movement to build up the general credit standing of their communities. The prosperity of the banker is inseparably wrapped up in the prosperity of his neighborhood. Loans made at rates averaging fifteen per cent, as in Oklahoma, where the risk of loss is very high, because of bad farming and bad financing, do not reflect prosperous banking.

If we were to rearrange the accompanying bar chart in the order of total expenses, it would be discovered that in those states where diversified farming has reached its highest development interest charges are lowest, while in those states which are still in the pioneer stage and which are still concentrating on one cash crop, "mining the soil," the total interest charges are highest. Some writers[1] have thought that the one-crop system is an important cause of the high interest rates in those states.

But such a view is not perfectly consistent. There is a strong tendency for the high money rates to operate, conjointly with the relative immobility of capital for the time being, to bring about the one-crop system. In a new country where a farmer has an abundance of cheap land and high labor costs, and where farming is for the time in a pioneer stage, his first problem is to get a better balancing of the factors of production. He is justified at this point in selling the fertility of the soil by "mining it" by a cash crop system to get money to buy equipment. If, as is usually the case in a pioneer agricultural section, capital is scarce and it is difficult to import capital, a condition causing high rates of interest, he will be further deterred from borrowing

[1] C. W. Thompson, Bulletin 409, U.S. Department of Agriculture.

capital, and this also forces him to "mine the soil." If he could get low rates of interest, he could get his needed equipment by borrowing so as to get the desired better balancing of the factors of production. In such a situation not only will he "mine the soil" of his own accord, but the rural banker will insist upon it if he is to lend money to the farmer.[1]

[1] I am indebted to Professor T. N. Carver for the theory of the one-crop system.

CHAPTER XIII

RECENT EVIDENCE OF THE FUTILITY AND MISCHIEVOUSNESS OF USURY LAWS IN THE FIELD OF COMMERCIAL AND INVESTMENT LOANS

THE American usury laws have already been proven to be futile and mischievous. By "futile" it is intended to mean that they are powerless to fix or affect the current market rates of interest. Furthermore, as pointed out by Irving Fisher, the individual can modify his income-stream by the method of the sale in other ways besides selling his promise to pay money. By "mischievous" is meant that usury laws have certain detrimental effects upon commercial relations. But in spite of the proof already given, it is frequently argued that "the trouble with the usury laws is that they are not enforced." In the present chapter, concrete evidence will be given from the actual business situation in the United States, showing the futility and mischievousness of the usury laws.

METHODS OF EVADING[1] THE NEW YORK USURY LAW AS EMPLOYED BY VARIOUS LENDERS

PURCHASED PAPER

It is legal for a note broker to sell commercial paper at seven or eight per cent or any higher rate, and it is legal for a bank to buy this paper, provided the title to the paper is definitely fixed as the note broker's. This is accomplished by the usual order "Pay to Ourselves" and by an

[1] The United States Supreme Court makes a distinction between an evasion of a law and the complete avoidance of a law. U.S. *v.* Ishem, 84 U.S. (17 Wall.) 496; 21 L. Ed. 728. See p. 23 above for ways of avoiding the usury laws.

endorsement in blank which by the Negotiable Instruments Law enables the title to be passed by delivery. Of course this definitely fixes the title in the note broker or any one else to whom the paper has been delivered.

In this case the sale or purchase is like that of a commodity, the price being regulated by current market rates. In the transfer of such paper the ownership passes from the seller to the buyer at a fixed price and the undisputed owner of the paper has a right to fix any price for his own property that he can get.

Two men, both desiring to borrow equal amounts of money, say $1000 each, could, before coming to the lender, give each other a promissory note for $1000. Each note balances the other so there is no usury. Then the men can take these notes to the banks and sell them for whatever the banks desire to pay. Of course it will not often happen that two borrowers will both want the same amount. This matter can be very easily adjusted by shrewd bargainers.

The law may be evaded by a bonus or premium upon the loan, although this system is pretty well prevented under some state laws. The law is also evaded by commissions to an agent who turns over the greater part of it to the lender as extra interest, by selling goods or real estate at a fictitious price, the excess over the real price being in the nature of interest. The law has also been evaded by "dry exchange," as when a note is made payable in another city, and "exchange" is charged for bringing the money home, although in fact the note has not left the city where the loan was made.

Requiring Balances

In lending to individuals, it is now considered proper to require them to maintain a balance in the bank of twenty to twenty-five per cent, so that, in case of a loan of $1000 at six per cent, the money actually used will be only $800. This makes the rate actually paid seven and one-half per cent. It is worthy of note, however, that this custom is

also used in states like Massachusetts and Rhode Island, where there are no usury laws, probably to compete on equal terms with the New York banks.

Requiring Incorporation[1]

This twenty or twenty-five per cent requirement is not strictly insisted upon in the case of corporations. By the New York usury law, corporations are not permitted to plead usury.[2] Corporations can be charged any desired rate. By reason of this fact, individuals are often required to incorporate before being granted bank credit. Thus the usury law operates to cause the formation of many corporations that otherwise would not be formed.

Using Liberty Bonds to Evade the Law

Some of the New York savings banks have recently been making building loans on the basis of one half cash and one half Liberty bonds at par. The man who takes these bonds stands indebted to the bank for the par value of the bonds. Of course he does not want bonds. He takes them and sells them at the market value. Thus, in the case of a loan of $1000 at six per cent, one half cash and one half bonds, if the market value of the bonds is only 90, the borrower does not get the full $1000, but pays six per cent on the full amount.[3]

The National Banks and Usury

On October 6, 1915, Mr. John Skelton Williams, Comptroller of the Currency at the time, amazed the business world by stating in a speech before the Kentucky Bankers' Association that many national banks were flagrantly violating the usury laws of the various states. The amazing thing about the speech was, not that the banks were breaking the usury laws, but that Mr. Williams thought that usury laws ought to be obeyed.

[1] From *United States Investor*, July 24, 1920.
[2] See pp. 60, 182, 212. [3] *United States Investor*, July 24, 1920.

On November 26, 1915, it was announced from his office in Washington [1] that:

> Twelve hundred and forty-seven national banks in thirty-six states, covering thirty-six per cent of the area of continental United States outside of Alaska, in their statement of September 2, 1915, admitted under oath that they were charging on some of their loans rates in excess of the maximum rates permitted by law of their own states or of the United States.
>
> Ten hundred and twenty-two national banks in twenty-five states were by their sworn statements charging an average of not less than ten per cent and in some cases eighteen per cent on all their loans.

He pointed out also that the maximum rate charged by twenty-six widely scattered banks was one hundred per cent or more per year. Later there was a congressional investigation into Mr. Williams's "charges against the banks." [2] Mr. Williams strenuously objected to referring to his statements as "charges," since he was quoting from the banks' sworn statements.

As a result of this investigation many interesting facts were disclosed. In Georgia, two thirds of the national banks admitted that they were charging more than the statutory maximum of eight per cent.[3] In Texas, 192 out of 534 national banks admitted charging during 1915 rates forbidden by law. One large bank reported four and one-half million dollars loaned out at from ten to twelve per cent.[4] In North Dakota, 96 out of 151, or two thirds, of the national banks were charging usurious rates.[5] Forty per cent of the banks in North Dakota reported that their rate averages were over the legal maximum of ten per cent. Some of the North Dakota national banks reported that the minimum charged to any borrower was ten per cent. There were similar results in other states. One bank in

[1] *New York Sun*, November 27, 1915.

[2] *Investigation of Usury Charges against Banks*, House Res. 64, January 17 and 21, 1916.

[3] *Ibid.*, p. 31. [4] *Ibid.*, p. 32. [5] *Ibid.*, p. 35.

Illinois, where the maximum is seven per cent, reported loans aggregating $20,000 made at twelve to fifteen per cent.

It was shown in Chapter III that the national usury law (Sect. 5197, U.S. R.S.) requires that all national banks shall obey the usury laws of the various states. But if most of the state banks in any state break the laws, and this is the usual case, it is manifestly unfair to prosecute the national banks under the federal laws.

Was Williams Charging Moral Usury or Legal Usury?

Later, in October, 1920, Williams amazed the financial world again by charging with "usury" New York banks which were charging high rates on call loans.[1] The remarkable fact in this instance was that in New York the call loans are exempt from the usury law, so that here he was not charging legal usury, but moral usury. But was there moral usury? Certainly not. There can be moral usury only in the absence of a market rate for loans, as, for instance, in some types of consumptive loans or in the case of agricultural loans in frontier countries. The New York call-loan rate is a resultant of economic forces and is followed by all bankers in making their call loans.

Now, if Williams was charging moral usury here, he must have implied moral usury in the speech before the Kentucky Bankers' Association. It is true that, if the only kind of usury is legal usury, he was not making "charges," but, if he meant moral usury, he was making charges. None of the banks admitted moral usury. There is no doubt that there were cases where banks made loans that were morally usurious, but it has already been shown that to set up the legal definition of usury makes it impossible in a usury trial to bring up the issue of moral usury. But there are many loans that are legally usurious that are not morally

[1] See *Wall Street Journal*, October 25, 1920; also *New York Times*, August 12, 1920.

usurious. It must be remembered that the real evil that society wants to get rid of is moral usury. This social purpose must not be lost sight of in the camouflage of politics.

Are National Banks Justified in Charging over Ten per cent or Twelve per cent on their Loans?

The Williams investigation showed that the most excessive rates were charged in the newer states where crop failures are frequent and where other risks of lending are rather high. In those states, such as, for instance, Oklahoma, such loans have usually been attended by unusual risks. In the towns of such states the bankers would prefer not to make such loans, but a lot of influence is brought to bear upon them by their communities, and, as there are no other lenders to take care of such loans, the banks make the loans on rates exceeding the lawful maximums.

In many banks it has been found that, if the total interest from all these loans is taken together and compared with the total amounts of the loans over a period of time, deducting losses, the average interest collected is seldom higher than ten per cent. This is the lawful maximum in most of the states of the type of Kansas, Oklahoma, or Texas.

Many small banks must make a large number of small loans to persons in straitened circumstances. In many small country towns the banker is compelled by community influences to perform the functions of the pawnbroker and the licensed lender. In view of the risks they take and the trouble connected with small loans, it seems that they should be allowed to charge rates higher than the ordinary statutory maximums for banks. A great many states have established maximums for small lenders of from thirty to sixty per cent a year. In fact, many small country banks find at the end of a year that there has been no profit at all on the total volume of such loans, and that all their profit has come from the regular commercial type of bank loans.

If a banker has to perform the functions of the pawnbroker and licensed small lender, he should be allowed to charge the rates that they must charge in order to stay in business.

If such borrowers could be eliminated from the banks' customers, so that all bank loans could be confined to those who are regarded as absolutely safe, it would undoubtedly be possible to keep the maximum rates below the ten per cent or twelve per cent in the western and southern states. But the village banker must make consumptive loans to the teacher, the minister, the small tradesman, and in fact to all types of people where the money goes to pay doctors' bills, funeral expenses, and other consumptive needs. The banker has to do this because there is no one else to make these accommodations. In view of these considerations, the enactment of drastic usury laws to prevent the village banker from charging more than ten to twelve per cent simply reacts to make it more difficult for the small borrower to get loans in those communities. If the banker cannot get a rate of interest proportioned to the risks involved, he would naturally prefer not to take the risks.

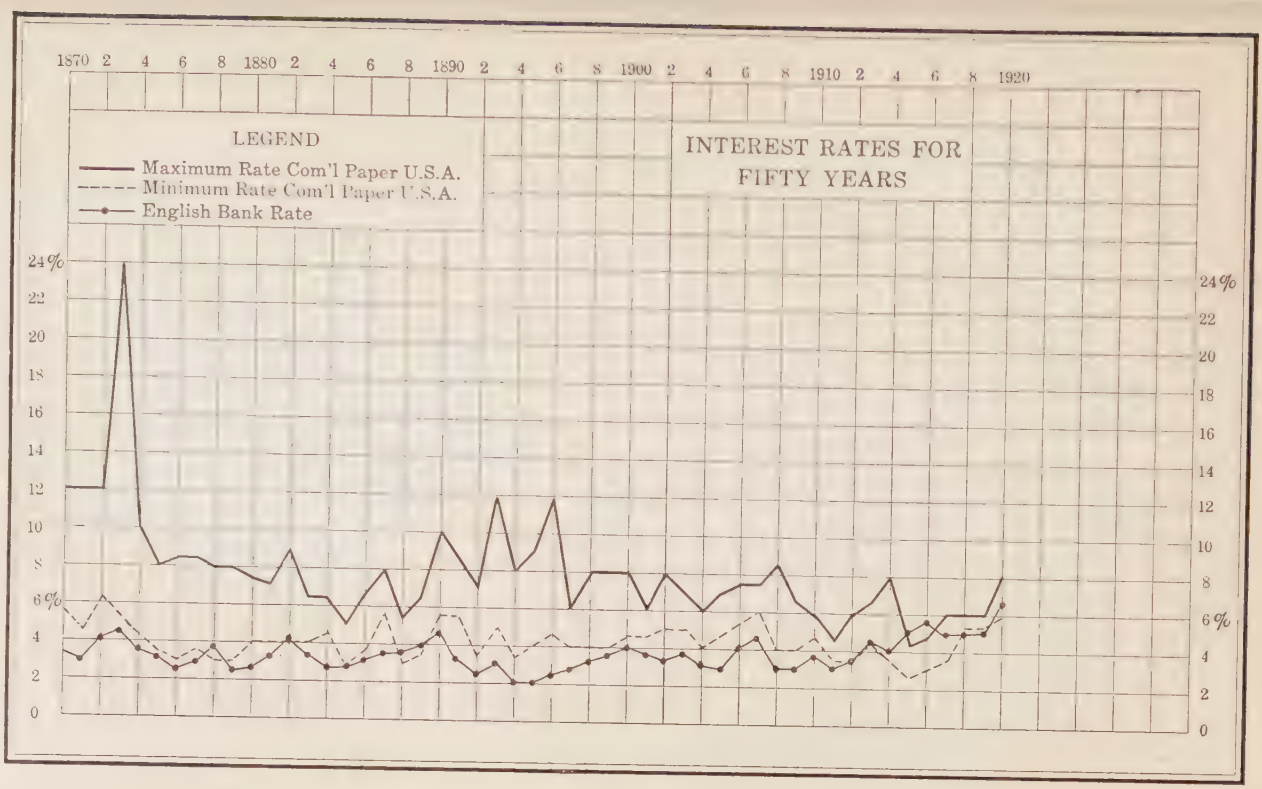
A country banker has this to say on this point:

> From my experience in the banking business running over many years in this and another state, I have found that, where any rate in excess of a legal rate was charged, it was in cases where a good deal of risk attended the making of the loan, also upon the ability of the borrower to take care of his obligation as well as his readiness to do so when he could do it.
>
> In the larger towns of this state [Oklahoma] such as this city, for instance [Sapulpa], the loans on which usurious interest is charged are very hazardous. We would not make them at all were it not for the demand from the business public that they be taken care of in some way.[1]

The Market Rate of Interest Fluctuates with no Regard to the Usury Laws

The accompanying Plate V gives a chart showing the movement of three different rates of interest for the fifty-

[1] H. A. McCauley, President, Sapulpa State Bank, *Oklahoma State Banker*, November, 1915.


INTEREST RATES FOR FIFTY YEARS
LEGEND
Maximum Rate Com'l Paper U.S.A.
Minimum Rate Com'l Paper U.S.A.
English Bank Rate
1870 2 4 6 8 1880 2 4 6 8 1890 2 4 6 8 1900 2 4 6 8 1910 2 4 6 8 1920
24%
22
20
18
16
14
12
10
8
6%
4
2
0

year period 1870 to 1920.[1] The graph shows the movement of the English bank rate and the maximum and minimum commercial rate in the New York money market. The English bank rate is considered the most stable short-term rate of interest in the financial world. The chart shows that not only have there been wide fluctuations in interest rates in this country, but that the English bank rate has also been subject to fluctuations. This chart also disproves the theory of some persons that at this time (1921) we were in an abnormal situation. The fact is that if the rate remained stationary, it would be abnormal. The normal thing for interest rates to do is to fluctuate.

During this period the rates on commercial paper have been seven per cent or more during thirty of the fifty years, above eight per cent in nineteen different years, ten per cent or above in seven different years, and reached twenty-four per cent in 1873. Thus it is shown that the usury law is "obeyed" only when its rate happens to be above the market rate. When the market rate happens to go above the statutory maximum, the law is invariably and always disregarded.

A Usury Law has no Effect upon the Fluctuations of the Market Rate of Interest

Professor H. Parker Willis, in "Why Money Rates are High," published in the "New York Evening Post" in February, 1921, presents a chart showing curves for time money, call money, acceptances in the New York market, and the call rate for London. This graph shows that time money was eight per cent for two weeks during November, 1920, and was above seven per cent during all of December of that year. In fact, it stayed above six per cent during several months.

Confirming this are the following quotations from the "Commercial and Financial Chronicle":

[1] The data covering the Bank of England rate were taken from a recent number of *The Bankers' Magazine*, of London. For bank rates in the United States the material was taken largely from *A Century of Prices*, by Burton and Selden.

October 23, 1920 (p. 1599)

In time money the situation remains without essential change. Funds are as scarce as ever, but the demand is light owing to the fact that borrowers are now looking for easier monetary conditions with the turn of the year. Nominally quotations are still at eight per cent for sixty and ninety days and four months, and seven and three-fourths per cent for five and six months with practically all of the business in the shorter maturities. All-industrial money remains as heretofore at eight per cent for sixty and ninety days and seven and three-fourths per cent for longer periods.

January 29, 1921 (p. 405)

In time money the market was almost at a standstill. A falling off in demand was noted while the supply of loanable funds was smaller. So far as could be learned, no large transactions were negotiated. Quotations which were largely nominal, have been advanced fractionally to six and one-half per cent for all maturities from sixty days to six months as compared with six per cent a week ago. . . . All-industrial money is dealt in as usual at about one fourth of one per cent above these levels.

The Findings of the Lockwood Committee[1]

During June, 1921, the Lockwood Committee made an investigation of the housing difficulties in New York City and incidentally unearthed a large mass of evidence that mortgage lenders have been breaking the New York usury law by charging interest from twenty to fifty per cent on real estate loans.

Through many different witnesses, Samuel Untermyer learned by sworn statements that savings banks, life insurance companies, trust companies, estates, loan companies, mortgage brokers, and money-lending institutions in general had been demanding and receiving bonuses, commissions, and discounts reaching up to twenty per cent for lending money at five and one half or six per cent interest.

In the case of three small mortgages it was shown that bonuses or discounts of thirty-three and one-third per cent, forty per cent, and fifty per cent above the contractual in-

[1] From *New York Times*, June 3 and June 25, 1921.

terest charges were received. In some cases it was discovered that borrowers were forced to take depreciated Liberty bonds at par in order to get loans. Builders in need of mortgage money were compelled to buy old tenements, widely scattered lots, etc., at high prices in order to make up for the interest rates taken above the limits allowed by the usury law.

One mortgage broker dealing mainly in third mortgages paid out $1,745,044 on the face value of mortgages amounting to $2,102,357, receiving $337,310 in bonuses in the space of a few years. In some cases borrowers were obliged to incorporate themselves so that they could not plead usury when banks and other lending organizations made conditions which meant the payment of eight to fifteen per cent interest without the charges for legal fees, title, brokerage, mortgage tax, and other charges. Witnesses admitted that they would not have bought lots, tenements, and other property if they had not been compelled to do so as a condition to getting loans.

A typical instance where a mortgage broker received an advance of fifty per cent over the amount he paid the borrower was shown by Mr. Untermyer. This man received a mortgage for $15,750 at six per cent for which he paid $10,750. The mortgage was to run for five years. The same man paid $14,000 for another mortgage of $19,000 at six per cent.

Before the Lockwood Committee took an adjournment for the summer, Mr. Untermyer was convinced of the futility and mischievousness of the usury law. He advocated its repeal, and pointed out that it was not to be expected that money could be borrowed at six per cent when investors could buy tax-exempt securities that would yield almost that amount, and could buy the highest class of railroad and industrial bonds on an eight per cent basis or better.

CHAPTER XIV

THE NON-SUMPTUARY USURY LAWS OF ENGLAND, INDIA, AND GERMANY

When the general field of interest laws was surveyed in Chapter II, mention was made of certain interest laws of foreign countries which aim directly at moral usury, and which do not set maximum interest rates by legislation. Such laws were mentioned also in the quotation from Mr. Warburg in Chapter I.[1]

For purposes of clearness it should here be repeated that in this study whenever the term "usury law" has been employed, it has been used in the American narrow technical sense. By "usury law" is meant the particular type of *general* statutory maximum law now in effect in forty-two states (Rhode Island not included), which type of law, when enacted, fixed limitations on interest rates of from six to twelve per cent for all kinds of loans. In view of the fact, however, that foreign countries have laws which they also call usury laws which do not set maximums, it has been necessary to differentiate them from the American type by calling them "non-price-fixing" or "non-sumptuary" usury laws. Whenever it has been desired to include both types of laws in one designation, they have been called "laws intended to prevent moral usury." They may also be called "usury laws in the general sense."

The English Money-Lenders' Act of 1900[2]

When the five per cent maximum of the Statute of Anne was repealed in England in 1854, it was provided that, in any action in which interest is recoverable, the amount shall be decreed by the court at the rate agreed upon be-

[1] See pp. 5–6 above. See also C. J. Bullock, *Introduction to the Study of Economics*, p. 435.

[2] See Extract from the law in Appendix F, p. 217 below.

OUTLINE OF INTEREST LAWS ENACTED FOR THE SOCIAL PURPOSE OF PREVENTING LENDERS FROM MAKING OPPRESSIVE BARGAINS WITH NEEDY OR INEXPERIENCED BORROWERS

- Interest Laws Enacted to Prevent Moral Usury.
  - I Statutory Maximums (sumptuary usury laws.)
    - 1. General Statutory Maximums
      - a. Ancient and medieval usury laws. (Maximums from zero up to ten per cent in most cases.)
      - b. American Usury Laws. (Maximums ordinarily from six to twelve per cent.)
    - 2. Special Statutory Maximums
      - a. Small-Loan Laws. (Maximums ordinarily from thirty to sixty per cent.)
      - b. Other special maximums. (In some states the maximum for loans secured by Liberty bonds is one per cent a month.)
  - II Non-Sumptuary or non-price-fixing Usury Laws.
    - 1. Common-Law Rules. (From 1854 to 1900 there was an English rule that "Equity will prevent the enforcement of any oppressive bargain.")
    - 2. Laws by which Moral Usury Voids the Contract.
      - a. Laws applying generally to all types of loans. (Example: the German law.)
      - b. Laws applying only to consumptive loans by small lenders.
    - 3. Laws by which the Court can Remake the Contract if there is Moral Usury.
      - a. Laws applying generally to all types of loans. (Example: India's law.)
      - b. Laws applying only to consumptive loans by small lenders (Example: the English Money-Lenders' Act, 1900.)

tween the parties. This was found to work well where there was a market rate of interest as a resultant of the interplay of economic forces. In the field of commercial and investment loans there was such a market. But in the field of consumptive loans, it was found that some kind of control was necessary.

In the case of consumptive loans there is often no such thing as free competition and no prevalent market rate of interest determined at the margin.[1] Borrowers for consumptive purposes often know very little about methods of getting loans. The need is often immediate and pressing. They have no time to shop around to see where they can get the best terms. Usually such a borrower wants the matter kept from his friends and employer. Consequently the shrewd and experienced money-lender was often enabled to drive hard bargains with such people and extort unduly high rates of interest. Because of these facts, it was found that it was not safe to leave all borrowers free to make such bargains, in the way of obtaining money as they see fit, or all lenders free to supply them upon any terms they see fit to make, as Bentham had advocated.[1]

But although by the repeal of the Statute of Anne the creditor acquired the power of demanding any amount of interest, yet the effect of that repeal was considerably modified in England by the power exercised by the Court of Chancery in respect to excessive bargains. After 1854 there grew up in England a rule of law that "Equity will prevent the enforcement of any oppressive bargain." [2]

As time went on, however, it was found that the courts did not have power enough. There were some cases where the courts could not interfere in the bargains of money-lenders. In the English Money-Lenders' Act of 1900 all these powers of the Courts of Chancery have been preserved and new powers have been added, designed to enable

[1] See Bentham's proposition, pp. 52 and 82 above.

[2] Stuart, V. C., in Barrett *v.* Hartley (1886), L.R. 2 Eq. 795; James *v.* Kerr (1889), 40 Ch.D. 449.

the courts to strike more effectively at moral usury. Under the English Money-Lenders' Act of 1900 the court may, if excessive interest has been charged, or if the transaction is harsh and unconscionable, or is otherwise such that a court of equity would give relief, reopen the transaction, and may:

(1) Relieve the person sued from payment of any sum in excess of the sum adjudged by the court to be fairly due, in respect of such principal, interest, and charges, as the court, having regard to the risk and all the circumstances, may adjudge to be reasonable.
(2) If any excess has been paid or allowed in account by the debtor, may order the creditor to repay it.
(3) May set aside, either wholly or in part, or revise or alter any security given or agreement made in respect of money lent by the money-lender, and if the money-lender has parted with the security may order him to indemnify the borrower or other person sued.

The Usurious Loans Act of India (1918) [1]

India also had a usury law like that of the Statute of Anne. When the five per cent maximum in England was repealed in 1854, India followed the example and repealed the statutory maximum in 1855. The same difficulties were, however, found in India as in England. But whereas in England the Courts of Chancery interfered to prevent unconscionable bargains by money-lenders, the courts in India refused to award interest at the contract rate where the rate was unconscionable within the meaning of the Contract Act of India of 1872 (Sections 16 and 19A).

The Usurious Loans Act of India, enacted in 1918, is different from any other law aimed to prevent moral usury. While the English Money-Lenders' Act of 1900 applies only to professional money-lenders, the new act in India

[1] I am indebted for data regarding the Usurious Loans Act of India to D. F. Mulla, *Usurious Loans Act* (1918), published in Bombay by N. M. Tripathi & Co.

See an extract from the Act in Appendix G, p. 219 below.

applies to all transactions by way of a loan whether in money or in kind. The money-lending transactions struck at by this act are

(a) Where excessive interest has been charged.
(b) Where the transaction is substantially unfair.

In transactions like these the court may reopen the transaction, and exercise the same powers as are given under the English Money-Lenders' Act. It is provided, however, that nothing in either act shall affect the rights of any *bona-fide* holder of a negotiable instrument, for value without notice.

These two acts mark a new departure in English legal principles. Prior to the Money-Lenders' Act of 1900, the court never remodeled a bargain. The Chancery, as Lord Nottingham said in 1676,[1] "mends no man's bargains." All that a court of equity did was to set aside a transaction which it considered unrighteous and give relief on terms. These recent acts of England and India gave the courts for the first time the power to *remake the bargain*. These acts actually empower the court to make a new bargain between the parties in place of the old bargain found to be at fault.

It might be interesting from a theoretical point of view to attempt to explain this new legal principle by saying that it gives a method of making a bargain as it would have been made had the parties been in equal bargaining positions; or, in other words, that the written contract, because of the unequal positions of the two parties, must be remade according to what the parties intended, but were prevented from putting in writing because of the lender's taking advantage of the borrower.

The Usurious Loans Act of India provides a code which outlines the various considerations which are to guide the court. In order to determine whether the interest is "excessive" the court is to consider:

(a) The risk run by the lender.
(b) The profit yield to the lender by the transaction.

[1] Lord Nottingham in Maynard *v.* Mosely (1676), 3 Sw. 655.

"Excessive" means in excess of that which the court deems to be reasonable in view of these considerations. Under the question of risk, the court is to take into account:

(a) The presence or absence of security and the value of the security as known to the lender at the date of the loan.
(b) The financial condition of the debtor as known to the creditor at the time of the loan.
(c) The result of any previous transactions of the debtor by way of loan as known to the creditor at the date of the loan.

Under the subject of yield to the lender, the court is to consider the total advantage which he receives under the contract from amounts charged or paid, whether in money or in kind, for interest, expenses, inquiries, bonuses, premiums, renewals, or any other charges, and, if compound interest is charged, the periods at which it is calculated.

In considering whether a transaction is substantially unfair, the court is to take into account all circumstances materially affecting the relations of the parties at the time of the loan or tending to show that the transaction was unfair, including the necessities or supposed necessities of the debtor at the time of the loan so far as the same were known, or must be taken to have been known to the creditor. Interest may of itself be sufficient evidence that a transaction was substantially unfair.

The German Law

A law directed against moral usury was introduced for the whole of Germany in 1880, and was amended and extended in 1893. This law made it a criminal offense to obtain a profit by taking advantage of the necessitous condition or inexperience of any person in reference to loans *or other transactions*, "exceeding the usual rate in such a way that the profit seems out of all proportion to the service rendered." The law made all transactions of this nature null and void.[1]

[1] Palgrave, *Dict. Pol. Econ.*, vol. II, article on "Interest and Usury," p. 434.

It can be readily seen that this law, although radically different from the typical American sumptuary or price-fixing usury law, is still different from the laws of England and India in that it merely makes the contract void when moral usury is established.

In American courts the only usury recognized by law is the taking of a greater interest than the law allows. Thus, if a usury case comes up in our courts, the issue as to whether there has been moral usury cannot be raised. This explains why so many of our usury cases have been wrongly decided on the basis of this false definition of usury. There should not be two definitions of usury. The ideal usury law would create a situation where moral usury and legal usury would coincide in meaning.

CHAPTER XV

AMERICAN SMALL-LOAN LEGISLATION

In the "Letters in Defense of Usury," Bentham presented valid arguments for the abolishment of legislative maximums for interest rates where the market rate of interest is determined at the margin by the interplay of economic forces. He did not distinguish, however, between the different types of loans, thus avoiding the point raised by John Locke that public control was necessary to protect people in want from being taken advantage of by greedy money-lenders. When Bentham spoke of "loans," he included in this one designation all types of commercial, investment, and consumptive loans.

A few years ago the activities of a particular type of money-lender began to attract wide attention in the United States. Because of his notorious practices in exploiting the financial extremity, actual or imagined, of poor people who were unable to borrow money from banks, so as to extort from them unduly high rates of interest, he was called "loan shark." Because of the two different definitions of usury in this country, the term "loan shark" has had two different meanings, but the real meaning in the popular mind is the lender who practices moral usury.

Some authorities have defined a "loan shark" as a lender who operates outside of the law, but this is obviously not a perfect definition. There were loan sharks everywhere in the industrial sections of the country. The paradoxical thing about the situation was that he flourished not only in states like Massachusetts, where there were no usury laws, but also in states like New York and Illinois, where there were usury laws with severe statutory penalties.

Yet this evil of taking advantage of the borrower in necessitous circumstances is the very thing against which all usury laws ancient and modern have been directed. The

social purpose of all kinds of usury laws (here used in the general sense) has been to eliminate moral usury. The problem is never solved until this purpose is achieved. Camouflaging the issue by establishing false definitions of usury will never improve the situation.

Dana, in his famous speech before the legislature of Massachusetts in 1867, fell into the same error that Bentham did. He did not foresee that Massachusetts was destined to have trouble with loan sharks. In later years when the rapid industrial development of Massachusetts created a situation where there was an enormous demand from wage-earners and other people of small means for loans for consumptive purposes, the various types of small lenders, attracted by the profits to be made, began to increase in numbers. Yet because of the necessitous position and urgent situation of borrowers, when seeking such loans — oftentimes to get money to bury a child or to buy medicines for a sick wife — such lenders could get almost any rate they asked for their loans. The rates were often as high as two hundred per cent a month. The average loan made by loan sharks was at about ten per cent a month.

But there was another factor that is often overlooked which had a bearing on the situation. There was a popular prejudice against the charging of rates for such loans even as high as two per cent a month. Two per cent a month is twenty-four per cent a year, yet no small lender would go into business at all if he could not get more than that, because of the high expenses and risks involved. A lender who charged three per cent a month was branded by the public as a "loan shark." This public condemnation of the business operated to keep many people out of it. Thus the lenders had to get some kind of compensation for being called "loan sharks." They got it by charging higher rates. The money-lender is only human.

In the states where there were usury laws, the laws themselves operated to increase the number of loan sharks. Let us examine, for example, the law of Illinois.

The Illinois Usury Law[1]

Seven per cent may be contracted for. In all written contracts it shall be lawful for the parties to stipulate or agree that seven (7) per cent per annum or any less sum of interest, shall be taken and paid upon every one hundred dollars ($100) of money loaned or in any manner due, or owing from any person or corporation to any other person or corporation in this state, and after that rate for a greater or less sum, or for a longer or shorter term, except as herein provided.

No greater rate shall be contracted for. No person or corporation shall, directly or indirectly, accept or receive, in money, goods, discount or thing in action, or in any other way, any greater sum or greater value for the loan, forbearance or discount of any money, goods or thing in action, than as above prescribed.

Penalty for contracting for more than seven per cent. If any person or corporation in this state shall contract to receive a greater rate of interest or discount than seven (7) per cent upon any contract, verbal or written, such person or corporation shall forfeit the whole of said interest so contracted to be received, and shall be entitled only to recover the principal sum due to such person or corporation. And all contracts executed after this act shall take effect, which shall provide for interest or compensation at a greater rate than herein specified, on account of non-payment at maturity, shall be deemed usurious, and only the principal sum thereon shall be recoverable.

As this law stood, it was practically without penalty, since the money-lender, however unconscionable his bargains, was guaranteed the principal at all events. Moreover, the courts of Illinois had held that interest in excess of the legal rate cannot be recovered after the borrower has voluntarily paid it. This law and the manner in which it was enforced made the position of the loan shark perfectly safe. The situation was virtually the same in all of the states with these antiquated statutory maximums. Very few people who sought loans from the loan sharks knew what the law was or that any redress was possible by taking the case into court. Of those who had such knowledge, only a small number cared to incur the loss of time

[1] *Hurd's Revised Statutes*, 1915–16, p. 1580, ch. 74, §§ 4, 5, and 6.

and the expense required in order to take the matter to trial. Furthermore, even if a case were decided against one of these lenders and he forfeited the interest, he would in no way be prevented from continuing in business. The mere loss of interest on a few such loans was not half as important to him as were the numerous instances where he lost both the principal and interest because of dishonest borrowers or because of their utter inability to pay because of unforeseen circumstances. The whole situation, the unknown risks he took, the mischievous and nugatory usury law, the condemnation from all classes of society, his heavy losses and the fact that he was guessing in the dark and in many cases making no net profits, tended to make him cold-blooded and hard-hearted. He was popularly branded as a criminal; society was against him; his business was illegal. All these things worked together to make matters worse. The only way he could get even with society was by unsocial acts.

Furthermore, the men who wanted the respect and approval of society would not go into such a business, and only men who had little regard for the law and who worked out schemes to evade the lawful maximums, would go into it.

Thus it came about that society in its desire to protect the needy borrower from exploitation and extortion, acting through the agency of public opinion, stigmatized the business of the lender as unsocial; and, acting through the agency of legislatures, made the business illegal. A lender could not make any profit at all under statutory maximums of twelve per cent per year or lower. The actual result was to increase the rates which borrowers were compelled to pay.[1]

Several plans were worked out to combat the loan-shark evil and eliminate moral usury. In some cases the usury laws were made even more strict by the enactment

[1] The situation in England in 1818 was very similar. See Appendix B, p. 196.

of more severe penalties. In some of the large industrial centers it was thought that, because of the relatively small volume of consumptive loans, the evil of moral usury could be overcome by philanthropic organizations such as the remedial loan associations which made a business of lending funds supplied by benevolent people at reasonable rates. The credit-union idea was also worked out to meet the situation. Under such an arrangement, people in moderate circumstances were enabled to borrow from their friends and fellow-workers on a safe basis.

The credit union, although a very excellent device for reducing risks and promoting the credit standing of its members[1] under the circumstances where it originated among the small farmers in Europe, is not, as its proponents seem to think it is, a complete answer to the small-loan problem in densely populated industrial sections of the United States. It works best in the field of productive agricultural loans, while small industrial loans are predominantly of the consumptive order. The two situations are very different.

The credit union, where successful in the field of loans to industrial workers, has been enabled to do business at less than three and one-half per cent a month for three basic reasons: (1) overhead expenses have been donated by a benevolent corporate or individual employer; (2) managers and officers customarily serve without pay;[2] (3) the fact that loans are made among a limited group, all acquainted with each other, reduces risks.

Under such conditions the credit-union idea among industrial workers has been a success and the extension of the plan is to be strongly commended, but it is difficult to see

[1] See pp. 9, 107 above.

[2] That it is very difficult to get efficient persons to serve as officers is brought out in Edson L. Whitney, *Cooperative Credit Societies (Credit Unions)*, [Bulletin 314 of U.S. Bureau of Labor Statistics], p. 48. This booklet is open to the criticism that it does not emphasize the difference between the effectiveness of credit unions operating in the field of productive loans and those in the field of consumptive loans.

how the credit union can ever become more than only a partial solution to the industrial small-loan problem.[1]

The instant a credit union endeavors to serve the general public, it will have to pay rent, it will have to pay a living salary to a manager, and it will have the usual run of office expenses. In short, its costs will become as great as those of the industrial licensed lenders, so that, unless the credit union proposes to give no return on the capital employed in the business, it will be obliged to charge fully as high rates as those charged by the industrial licensed lenders. The advantages which reduce costs begin to disappear at the point where a credit union is organized to serve the general public.

Regardless of the existence of remedial loan associations and the organization of coöperative credit unions, people still went to the professional money-lenders. There was nowhere near enough benevolent money to meet the demand and the credit-union idea did not grow fast enough.[2] It was also discovered that the professional money-lenders would often make loans that the benevolent associations and credit unions would not think of making because of the risks involved. It began to dawn upon the public that the loan shark in some cases was really performing a necessary function. It began to be realized that even where he charged three and one-half per cent a month (forty-two per cent a year), he was making only a reasonable charge when his costs and risks were understood. He often made loans without any security at all. The average loans ranged from twenty to sixty dollars according to locality and conditions. He seldom made a loan over two hundred and fifty dollars.

[1] See Bergengren, *Coöperative Banking, a Credit-Union Book* (Macmillan, 1923), p. 69. The author admits the slow growth of credit unions.

[2] See Edson L. Whitney, *Coöperative Credit Societies (Credit Unions)*, Bulletin 314, U.S. Bureau of Labor Statistics, November, 1922, pp. 35–36. This bulletin points out that, although acts authorizing the establishment of credit unions have been passed in eleven states, credit unions have been organized very slowly, and at that time (1922) were in existence in only seven states.

Most of the borrowers needed money so desperately that it made no difference to them what the charges were. On the loans ranging from one dollar up to twenty-five dollars, the lender was compelled to charge high rates or show no profit at all. On this class of very small loans when made without security, the lender often was justified in charging as much as five per cent a month. But in many cases where no studies in risks had been made, he charged "all that the traffic would bear."

People began to realize that, in attempting to protect the poor from the extortions of greedy money-lenders by the enactment of the typical usury law, with its maximums of from six to twelve per cent, legislatures had defeated the social purpose of the law. It was not merely a problem of protecting the borrower; it was also a problem of getting somebody to lend. The law operated, by stigmatizing the loan business, to reduce the number of lenders or else to cause rates to be raised in order to cover the risks of breaking the law. As a result of all these well-meaning attempts to protect the borrower, we have in the United States to-day a hopeless tangle of conflicting usury statutes which for many decades have been in a slow but continual process of being enacted, changed, amended, whittled away, or repealed according to the ideas of legislators and reformers.

A few years ago the Russell Sage Foundation, an endowed philanthropy of New York City "for the improvement of social and living conditions," began to study this matter of lending money to needy borrowers with a view to putting it upon a scientific basis and correcting all these abuses. This organization made careful investigations of the small-loans business in all its varieties and in all parts of the United States. It was the Foundation that was chiefly instrumental in establishing from twenty to thirty corporations, known as "Remedial" or "Provident" Loan Associations, in many of the larger cities.[1]

[1] F. R. Hubachek, in the *Year-Book of the American Industrial Licensed Lenders' Association* (1920), p. 26.

It should be noted here that the "small-loan" business has come to have a narrow restricted meaning. It is a business of distinct classification differing from other professional money-lending. It has existed for about thirty years and was never conducted at the general rates of interest allowed by the usury laws. This business is separate and distinct from that of pawnbroking. The pawnbroker advances money on the security of property left with him and pledged for the payment of the loan, but the "small lender" lends money on either the unsecured promissory note of the borrower, or upon his note secured by a mortgage on household furniture left in the use of the borrower, or by an assignment of wages or salary. Such lenders, whether individuals, firms, incorporated associations, or stock corporations, employ a small amount of capital in the business of $12,000 to $20,000 on the average. They take no deposits and do not deduct interest in advance.[1]

Where a form of security is taken — as, an assignment of wages to be earned in the future, or a mortgage on household furniture left in the use of the borrower — such "security" can seldom be realized upon by legal processes. On the other hand, the pawnbroker is protected by having a lien on property of value actually in his possession. The "Remedial" and "Provident" Loan Associations have usually followed the practices of the pawnbrokers.

The Russell Sage Foundation discovered a great many fundamental facts in regard to the making of consumptive loans. Upon the basis of these findings, a "Uniform Small-Loan Law" was prepared and recommended to the legislatures of the various states. With only slight variations the law has been adopted by Maine, Illinois, Indiana, Maryland, Pennsylvania, Virginia, Arizona, Connecticut, Georgia, Iowa, and Rhode Island.

The chief feature of the law[2] is that it fixes a special

[1] Clarence Hodson, *Money Lenders, License Laws, and the Business of Making Small Loans*, p. 6.

[2] See the general form of the Uniform Small-Loan Law, Appendix H,

statutory maximum of three and one-half per cent a month (forty-two per cent a year) for this type of loan. The Foundation had discovered that the costs and risks of the business were so high that such a rate would have to be legalized, not only to get lenders to go into the business, but also to get legitimate capital to go in at all. The law has other unique features in addition to the rate of three and one-half per cent a month. It fixes severe penalties, such as fine and imprisonment, for violations; it requires a $1000 bond; it provides that the maximum loan shall be $300.[1] The most important provision, however, is that the licensed lender "shall keep such books and records in his place of business as, in the opinion of the licensing official, will enable the licensing official to determine whether the provisions of the act are being observed." Each lender must preserve his records of loans for at least two years.

During the early stages of the studies made by the Foundation, it was thought that three per cent per month was a reasonable maximum limit for such loans, but, as more figures were obtained later, it was discovered that three and one-half per cent was the better figure.[2] Utah, Oregon, New Jersey, and Massachusetts have laws fixing the three per cent maximum. Michigan and New Hampshire have this maximum, but allow fees which bring the total rate up to more than three and one-half per cent on the average. The Foundation, however, is opposed to fees

pp. 222–227. Much credit must be given to the Legal Reform Bureau of New York City, for getting this new law enacted in the several jurisdictions.

[1] The appropriate maximum of any small loan was first worked out by Benjamin Franklin, as set forth in his will in 1791, which provided two funds of $25,000 each to be employed in Philadelphia and Boston, to be made available by the trustees for loans up to $300 to young married artificers, repayable in ten installments.

[2] See Clarence Hodson, *The Fair Rate of Interest for Small Loans.* Published by Legal Reform Bureau, New York, 1923. This gives a complete study of the different factors which have influenced the rates of charges for small loans. See also Reginald H. Smith, *The Scientific Rate of Fair Charges* (1922). Also published by the Legal Reform Bureau.

of any kind. According to its conclusions, the best plan is to allow a straight maximum to be computed on unpaid balances. New York and Missouri allow a two per cent maximum with additional fees. Until a year ago (1923) the law of Rhode Island stood unique among all statutory maximums. This was the only state which had a general statutory maximum of thirty per cent. In other words, the legislators of that state attempted to combine the old usury law and the new small-loan law into one. For loans under fifty dollars in amount, five per cent per month was allowed for the first six months. Virginia has a small-loan law fixing a special three and one-half per cent maximum on small loans over fifty dollars. On loans below fifty dollars, five per cent per month may be charged for the period of the loan.[1]

It can be seen that there are only a relatively small number of states that have reasonable small-loan laws which will enable a professional money-lender to make a profit. Other states have other types of small-loan laws which do not recognize the expenses and risks of the business.

The latest development in this field was the enactment on April 14, 1923, of the Uniform Small-Loan Law in the state of Rhode Island. The situation which led up to this legislation was somewhat unique. This event reveals, to a marked degree, the fact that legislators everywhere are recognizing the merits of the law. An account is given below:[2]

Rhode Island was the first state in 1923 to pass the Uniform Small-Loans Act and it was the first state to pass the act by unanimous vote.

The bill passed the House of Representatives in due course. But the situation in the Senate at that time was quite unusual. The Senate was evenly divided by the Republicans and Democrats, and for six weeks a filibuster had been in progress so that no legislation of any description had been enacted. Despite this diffi-

[1] See table of Small-Loan Laws, Appendix I, p. 244.

[2] I am indebted to Mr. Reginald H. Smith, counsel for the Legal Reform Bureau, for this account of the enactment of the Rhode Island Uniform Small-Loan Law.

culty, the Bill passed by unanimous vote. In this instance "unanimous" did not mean that the Bill passed in silence because no one objected, but actually meant that every legislator present raised his voice and voted "Aye." The Small-Loans Bill was about the only measure to get through the jam. Party issues never beclouded the Bill and its passage speaks well of the inherent merits of the legislation.

The Governor signed the Small-Loans Act on Saturday, April fourteenth.

In many states the business of pawnbroking is governed by a separate kind of small-loan law called the "pawnbroking law." Some states allow pawnbrokers a higher maximum than the "small lenders" are allowed. Colorado with no penalty for usury fixes the unreasonable maximum of one per cent per month on "small loans," but allows pawnbrokers three per cent per month. Such a law would naturally operate to increase the number of pawnbrokers. Arizona enacted the "Uniform Small-Loan Law" in 1919 allowing three and one-half per cent to "small lenders," but Arizona has a pawnbroking law which allows a monthly four per cent maximum. Delaware, with a very inadequate small-loan law, allows pawnbrokers eight per cent per month. Virginia allows pawnbrokers ten per cent per month on loans less than twenty-five dollars, five per cent a month on loans from twenty-six to one hundred dollars, and three per cent a month on loans over one hundred dollars. Massachusetts laws are equally paradoxical, allowing only three per cent per month on small industrial loans, but as high as five per cent on pawnbrokers' loans secured by physical pledge of property or security.

There is no adequate term that describes the small-loan business. This presents a problem that has not yet been solved. Because of the recent origin of the business, and in view of the fact that such lenders were called "loan sharks" for a long time, "loan shark" continues to be used by undiscriminating writers, although it is an epithet that should be reserved for those who practice moral usury. It should be recognized that those men, who, at the risk of

their own capital, are making it possible for necessitous borrowers to obtain small loans at fair rates, are filling a gap in our credit structure and are performing a highly important social and economic function. In seeking for a suitable name the members of the profession themselves have adopted the term "industrial lender." This seems to be the best term available. These men have formed themselves into a national organization for the improvement of the business which they call "The American Industrial Lenders' Association."

Because of the tendency in the minds of many people to confuse this business with that of pawnbroking, it is well to note the difference in the security taken. The pawnbroker is a bailee of the actual security for the loan. The "industrial lender" is never a bailee, but often takes a security title to mortgaged goods. The pawnbroker has higher overhead expenses than the "industrial lender" because he must provide space for the pledged articles, but the "industrial lender" has greater losses from bad debts because of the risks he takes. The pawnbroker can sell the pledged goods, if loans are not paid within a certain time, but the "industrial lender" must often go to great expense to hunt up the borrower and get him to pay.[1] The expense of dunning the borrower is often more than the amount of the loan.

Results of the Small-Loan Laws

These small-loan laws have accomplished remarkable results in eliminating the "loan-shark" evil and preventing moral usury. Many pages could be written telling of what these laws have done, but it is only necessary to quote from Mr. William Baldwin, assistant director of the Department of Trade and Commerce in Illinois, to show what is being

[1] See Albert Knight, *Guarding against Fraud in the Small Loan Business*, Bulletin of the National Federation of Remedial Loan Associations, September, 1923, pp. 25–28. Also see pp. 28–40 of same bulletin.

accomplished by these laws. On February 4, 1920, Mr. Baldwin said:

> I administer the Small-Loan Act in Illinois. It is the Uniform Small Loan Act sponsored by the Russell Sage Foundation of New York. After two and one half years' experience in Illinois I believe it has driven the old-time loan shark out of business here. It is estimated that there are loans aggregating $5,000,000 under this act in my state.
>
> The minimum old rate obtaining in Illinois prior to the enactment of this law was ten per cent per month. The uniform act provides for a rate of not to exceed three and one half per cent per month. This alone has saved the borrowers in Illinois upward of $4,000,000 per year.
>
> I believe it is a good law and should be enacted into law in every state in the Union.[1]

Constitutionality of Statutory Maximums for Interest Rates

The constitutionality of statutory maximums for interest rates seems to be questioned somewhat in the United States Supreme Court decision [2] in Adkins *v.* Children's Hospital, April 9, 1923, that a minimum-wage law for women and children is unconstitutional.

It was held that a minimum-wage law violates the constitutional guarantee of freedom of contract implied in the Fifth and Fourteenth Amendments. The opinion distinguished this decision from other decisions upholding maximum-labor laws and other statutes limiting labor contracts that have been upheld.

According to the opinion, it is one thing to require that employees be paid in cash or every two weeks, or that there shall be factory inspection, or to say that excessive hours are detrimental to health and therefore may be forbidden. But it is quite another thing to say that the employee shall

[1] *Proceedings*, Twelfth Annual Convention, National Federation of Remedial Loan Association. Published as a bulletin, August, 1920.

[2] See F. W. Ryan, "The Wage Bargain and the Minimum-Wage Decision," *Harvard Business Review*, vol. II, January, 1924, pp. 207-18.

be prevented by law from making an ordinary business bargain as to the wages he shall receive during the period of time when work is permitted by law.

The court said:

> A law forbidding work to continue beyond a given number of hours leaves the parties free to contract about wages and thereby equalize whatever additional burdens may be imposed upon the employer as a result of the restrictions as to hours, by an adjustment in respect of the amount of wages. . . .
>
> It is simply and exclusively a price-fixing law, confined to adult women (for we are not now considering the provisions relating to minors), who are legally as capable of contracting for themselves as men. It forbids two parties having lawful capacity — under penalties as to the employer — to freely contract with one another in respect to the price for which one shall render service to the other in a purely private employment where both are willing, perhaps anxious, to agree, even though the consequence may be to oblige one to surrender a desirable engagement and the other to dispense with the services of a desirable employee.

The basis for the restriction of freedom of contract on the one hand, in the case of statutes relating to modes of payment and fixing of hours, is to be found in the police power of the state. It is well recognized that the state has power to protect its subjects against fraud and ill health.

In the course of the hearings, the argument was advanced that, if the usury laws are constitutional, the minimum-wage law should be held constitutional, but this apparently had little weight in the final decision.

Yet the constitutionality of loan laws fixing maximum rates of interest is clearly settled. Fixing maximum rates of interest on money loaned within the state by persons subject to its jurisdiction is within the police power of the state. A small-loan law which establishes a special statutory maximum for a particular class of loans is also constitutional.[1] The provision of the Constitution of the United States prohibiting the states from impairing the

[1] Griffith *v.* Conn., 218 U.S. 563, December 12, 1910; Engel *v.* O'Malley, 219 U.S. 128; State *v.* Sherman, 18 Wyo. 169, 105 Pac. 299.

obligation of contracts [1] applies only to contracts lawfully made, not to such as are illegal and contrary to public policy, such as agreements violative of usury laws intended to protect the necessitous from the oppression of unscrupulous persons.[2]

In Otis *v.* Parker (1903), 187 U.S. 606, Justice Holmes, giving the opinion of the United States Supreme Court, said:

> No court would declare a usury law unconstitutional, even if every member of it believed that Jeremy Bentham had said the last word on that subject, and had shown for all time that such laws did more harm than good.

The power to regulate interest charges has so long been recognized as a constitutional exercise of legislative authority, and has been so uniformly sustained by the courts upon grounds of public policy, that it is now too late to ask the court to consider it an open question.[3] If the usury laws were to be tested now for constitutionality, it could be held that, since the laws are older than the Constitution and older than the amendments from which the doctrine of freedom of contract grew, the framers, knowing of such abridgments of the right of freedom of contract, did not intend to repeal the usury laws.[4] In interpreting the Constitution, regard must be given to the intent of the framers and to the circumstances attending the formation of the government.[5] New constitutions and new amendments

[1] U.S. Const., Art. 1, Sec. 10.

[2] W. R. Vance in *Cyclopedia of Law and Procedure* (New York, 1912), vol. 39, p. 910; State *v.* Griffith, 83 Conn. 1, 74 Atl. 1068.

[3] Dunham *v.* Gould, 16 Johns (N.Y.) 367.

[4] See State *v.* Goodwill, 33 W. Va. 179 (1889). I am indebted for this point to Mr. Reginald H. Smith, of the Boston Bar.

[5] Pollak *v.* Farmers Loan & Trust Co., 158 U.S. 601, 627. This principle is illustrated similarly in Flint River Steamboat Company *v.* Foster, 5 Ga. 194, and Byers *v.* Commonwealth, 42 Pa. (6 Wright) 89, where it was ruled that a constitutional requirement that the right of trial by jury shall remain inviolate does not confer the right where it did not exist before the adoption of the Constitution. (31 Cent. Dig., tit. "Jury," § 16.) U.S. Const., Art. 3, Sec. 2, Clause 3, reads, "The

operate prospectively only, and all preëxisting laws remain undisturbed, unless an intent to repeal all such is expressed or necessarily implied.[1]

Another theory upon which the statutory regulation of the taking of interest has been held to be constitutional is that since, under the ancient common law, it was unlawful to take any interest at all, and since Parliament interfered and made the taking of a limited amount of interest lawful (by 37 Henry VIII, ch. 9, in 1545, and again by 13 Elizabeth, ch. 8, in 1571),[2] the taking of interest is a privilege granted by government, and therefore government has the right to regulate and limit the privilege so granted by it.[3]

Economic Considerations Regarding the Uniform Small-Loan Law

We now arrive at another convenient stopping-place in this study. Let us now briefly take up a few additional points for criticism and evaluation.

In discussing the problem of the constitutionality of usury laws, the question arises:

If we hold that a general statutory maximum for loan charges is wrong in principle, how can we hold that a special

trial of all crime, except in cases of impeachment, shall be by jury." In a trial as to whether this meant that trials in equity should be by jury, it was held that the framers of the Constitution knew of the exceptions and that the provision recognized the exception.

[1] Calhoun County Supervisors *v.* Galbraith, 99 U.S. 214, 25 L. ed. 410; City of New Orleans *v.* Vergrule, 33 La. 35; State *v.* Pickett, 46 La. An. 7, 14 South, 340; State *v.* Macon City Court, 41 Mo. 453; Pegram *v.* Cleaveland, 64 N.C. 557.

[2] See p. 45 of this monograph.

[3] Munn *v.* Illinois, 94 U. S. 113, 153 (1876). This theory, although interesting, is based upon the false assumption that it required a legislative act to make capital productive. Capital investments in instruments of production yielded returns long before the beginnings of the English common law. The Code of Hammurapi, King of Babylon, about 2250 B.C., seems to have been based upon a better understanding of the economic laws of interest than were the American usury laws. See pp. 38–39 above.

statutory maximum like that of the Uniform Small-Loan Law is right in principle?

To approach this problem, it is well to begin by summarizing the reasons why general statutory maximums are wrong in principle. These are:

(1) They are based upon the false assumption that it costs the same to make all loans, thus ignoring differences in kinds of loans, risks involved, duration and size of loan, and other factors.
(2) They are powerless to control the market rate of pure interest on productive loans.
(3) They are mischievous and detrimental in their effects upon commercial and financial relations.
(4) They set up a rigid false definition of usury which relegates the true definition of usury to the background. This defeats the social purpose of the laws, namely, to prevent moral usury.

It is not easy to dispose of this first argument. Although the three and one-half per cent maximum in the Uniform Small-Loan Law is clearly intended to represent an approximate quantitative measurement of what an average fair rate ought to be on all kinds of consumptive loans, it too is open to the serious objection that it is a rigid maximum and sets up a "legal definition of usury" at forty-two per cent a year, just as did the old Statute of Anne with its maximum of five per cent.

But at any rate the Uniform Small-Loan Law is a noteworthy step forward. It recognizes the field where moral usury occurs, namely, the field of consumers' small loans, and seeks to eliminate the evil from that particular field by a maximum fitted to that field. The law is not perfect, but it attempts to remedy the situation complained of in the first objection, and it actually does remedy the situation to the extent that it sets up a special maximum for a particular class of loans. It recognizes the fact that the costs of consumers' small loans are much higher than the costs of productive loans, which is something that the old usury laws failed to do.

The three and one-half per cent maximum, even though it is but an approximation to an average of what is fair and reasonable, has been found to work out well in actual practice. Each small lender has an average variety of all kinds of small loans, so that in the long run the maximum works all right. But there are certain kinds of small loans which ought to be permitted a higher rate than three and one-half per cent a month, and certain other kinds which should not be made at such a high rate. In Chapter XVI I have set forth a method by which the Uniform Small-Loan Law can be further improved.

Before taking up the second argument, the third point can be quickly disposed of. The Uniform Small-Loan Law cannot be mischievous and detrimental in the field of commercial and investment loans because it is limited to consumers' small loans under three hundred dollars.

Now, turn to the second argument against general statutory maximums. The Benthamite economist may impatiently urge that, since a general statutory maximum such as a usury law cannot possibly interfere with the rate of interest, there is no use in employing any kind of a statutory maximum, such as a small-loan law, to govern in the field of consumers' small loans. It might also be urged that Irving Fisher's proof of the futility of usury laws to control interest proves the futility of all kinds of statutory maximums.

But Fisher was talking primarily about the rate of pure interest which may appear in either implicit or explicit form. Loan charges are made up of several items in addition to pure interest, such as overhead costs, indemnity for risks, etc. The Uniform Small-Loan Law is concerned with a problem that is not primarily a problem of pure interest.

In the field of productive loans (commercial and investment loans), where the charge would be say six per cent per year for a loan of $10,000, this charge is made up mostly of pure interest, say four and one-half per cent and one and

one-half per cent for overhead, risks, and other costs. In such loans pure interest is the chief item. The other items are relatively small, and, furthermore, they are relatively constant in magnitude. In such loans, if there are variations from time to time in the rate of charge, these variations are caused by variations in the rate of pure interest itself, which, as has been shown, cannot be controlled by a statute.

In the field of consumers' loans where a fair charge would be thirty-six to forty-two per cent per year, pure interest is a relatively small part of the total. In such cases the charge is made up mostly of costs for assuming risks, costs of bookkeeping, collections, etc. Here the part that represents pure interest is very small and not over one-eighth of the forty-two per cent total charge. Here again it would be, say four and one-half per cent per year. As pure interest rates fluctuate but a few points from time to time with the business cycle, the chief variations in consumers' loan charges are variations in the total amount of the other costs which are not interest.

Furthermore, in the field of commercial and investment loans, each variation in the rate of pure interest extends to every loan simultaneously. It is a variation in time and affects all loans alike. The rate of pure interest is determined by a vast interplay of the economic forces of supply and demand; that is, of the cost of saving on the one hand and productivity of capital on the other. This pure rate of interest, although difficult to isolate in any loan charge, is determined and regulated by a different set of forces from those which operate to bring about the charge for a small consumptive loan.

But in the field of consumers' small loans, the variations in charges are chiefly not variations in general rates from time to time. These variations are mainly variations in actual costs in individual loans. The cost is not a general level of costs extending simultaneously to all the loans. In other words, while variations in rates of pure interest in

any money market, are successive variations only, variations in the sum of those elements of a loan charge which are not interest are not only successive but also simultaneous variations. When I lend to A, who borrows twenty-five dollars for one month at three and one-half per cent a month to buy coal, or to B, who borrows one hundred dollars for six months to pay doctor's bills, I have individual cases where costs are determined by the particular sets of circumstances.

In these loans the desirability of the loan to the borrower is very great. So great, indeed, is such desirability that he will gladly pay as high as ten per cent or twenty per cent a month. It is clear, then, that in such cases, where the rate is not determined at the margin by the free interplay of economic forces, but is a resultant of the unequal bargaining positions of the parties to the loan, and where the borrower is always at a disadvantage, government is justified in stepping in to establish fair dealing. Freedom of contract is a fiction in such relations. Twenty years ago it was impossible to say what was a fair rate for such loans. But to-day, as a result of scientific studies and actual experimentation, it is generally accepted that a fair rate has been worked out. In the past it was thought that the rate for commercial loans was a fair rate for such loans. To-day we know that such guesswork was a colossal blunder.

Let us now consider the fourth argument. It may truly be objected that this special maximum which is set up by the Small-Loan Law at three and one-half per cent per month, or forty-two per cent per year, is no different from a maximum of six per cent per year in that it also sets up a false legal definition of usury, namely, that usury is simply the taking of more than the law allows.

There was no doubt that in the past the maximums of the old usury laws were based upon false reasoning. But it is here maintained that if we can by scientific studies fix a maximum in the field of small loans (the only place where moral usury can occur) which will be a fair maximum, then we shall have accomplished what our legislators set out to

do, namely, to set up a legal definition of usury which will be quantitatively approximately the same as the moral definition.

We need not leave the issue of moral usury to juries. Although a statutory maximum sets up a rigid definition of usury so that the issue of moral usury cannot come up in a lawsuit, we can get along better by not having the issue come up. Moral usury can be compared with other legal standards, such as the standard of good faith of a fiduciary, the standard of due care of a person pursuing an affirmative course of conduct, and the standard of reasonable facilities and reasonable service required of a public utility. These standards admit of application with reference to the facts of particular cases and yet are confined within legally ascertained limits.[1]

All moral usury, which is the evil aimed at by the usury laws and by the Uniform Small-Loan Law, can be quantitatively measured upon the basis of scientific studies. It is true that the ideal situation is to describe it qualitatively, but since moral usury has to do with loan charges which are numerical quantities, methods can be devised for measuring it quantitatively. In the final analysis true usury is an extortionate rate of charge for a small consumptive loan. If we have all the data, we can determine fairly accurately what a fair charge ought to be. This has been done. If experts determine by economic studies what are reasonable charges, then moral usury can be measured quantitatively. The Uniform Small-Loan Law does this. It is not perfect, but it is a long step ahead of the old bungling usury laws which were based upon prejudice and guesswork. It is based upon scientific research by impartial organizations of experts.

Furthermore, the Uniform Small-Loan Law works. It

[1] See Roscoe Pound, "Administrative Application of Legal Standards," in *Reports of American Bar Association*, vol. 44, pp. 445, 456–58. See also Bruce Wyman, *Public Service Corporations*, ch. 23; Joseph Story, *Equity Jurisprudence*, vol. 1, § 308.

gets results. In every state where it has been enacted it has been found effective. It has gone a long way in eliminating the loan-shark evil, thus finally attaining after many generations what the original framers of usury laws intended that they should accomplish.

It would be a distinct loss if our usury laws were to be declared unconstitutional. We should then be compelled to start all over again and build up some new system of eliminating moral usury, possibly like the systems of England, Germany, or India. It is erroneous to think that this country would gain by scrapping the system of legal machinery now in use. The legal theory of a usury law and of a small-loan law is correct economic theory and has the approval of economic authorities. If we can apply this theory in a scientific way, it will work all right. But the theory of a usury law was never expressed as an attempt to control the market rate of interest. It is simply using the police power of a state to remedy a bad situation where two parties are in unequal bargaining positions.

The Individualization of Cases of Usury

A sufficient number of states have enacted the Uniform Small-Loan Law to show that the trend in American usury legislation is definitely away from the old usury laws as devices to prevent and eliminate moral usury. This is a movement toward the individualization of cases of usury. It is in line with what the science of law is trying to do on every side. The problem of the individualization of the application of legal precepts is the great problem of the moment. On this point, Dean Roscoe Pound says:[1]

> More recently throughout the world there has come to be a reaction against administration of justice solely by abstract formula. . . . To find a proper mean between a system of hard-and-fast rules and one of completely individualized justice is one of the inherent difficulties of all administration of justice according to law. And in the movement to and fro from the over-arbitrary to the

[1] Roscoe Pound, Introduction to the English translation of Saleilles, *Individualization of Punishment* (Boston, 1913), p. xv.

over-mechanical, the eighteenth and nineteenth centuries stood for the latter.

The old system aimed to fit every case to the rules; the new movement of individualization aims to fit the action of the court to the case itself to prevent and eliminate moral usury. In other words, since our legislators have discovered that the old usury laws with their rigid definitions of usury were mere formulas which worked injustice both upon lenders and borrowers, they are now enacting laws which will fit the difficulty. It can thus be seen that the new Uniform Small-Loan Law is not only a great forward step in economic science; it also signalizes an advance in the progress of the science of law.[1]

In this study of the general problem of usury, the particular problem of the small loan is stressed because in this field all the aspects of usury are thrown into high relief and are clearly revealed. Abstruse economic principles become more understandable in the form of dramatic human episodes. The distinction between moral usury and legal usury stands out plainly beyond any possible doubt. The man who loans $100 to his fellow-man who desperately needs it for a month, and who charges him $3.50 therefor and makes a profit of less than a dollar on the transaction, is not a "usurer" in any true sense of the word. He is rather a benefactor. He is not a "usurer" because his net profit is no more than a fair remuneration for the service rendered; he is not a "usurer" because, instead of exploiting the borrower, he is extending to the borrower precisely the financial assistance that he needs — a help which no urban commercial or savings bank and few charities would think of extending.

It has been pointed out earlier that the only reason that can be ascribed to the legislators' refusal to repeal the general six, eight, and ten per cent usury laws was their

[1] On individual application of legal precepts, see Roscoe Pound, "Preventive Justice and Social Work," in *Proceedings*, Washington, D. C., meeting of the National Conference of Social Work, p. 151.

sincere and well-intentioned determination to prohibit moral usury and exploitation. Yet, when legislators have honestly and without prejudice examined into the small-loans field where moral usury typically occurs, they have been forced by the facts to repeal the six, eight, and ten per cent statutory maximums in the field of small loans and to substitute therefor far higher rates of lawful interest — in most cases three and one-half per cent a month.

Legislators in states where no such provision for consumers' small loans has been made may well be assured their six, eight, and ten per cent usury laws, instead of protecting the poor borrower and eliminating moral usury, have in fact turned necessitous borrowers over to the mercies of the worst type of lenders, the true loan sharks, and have created a condition under which their humbler citizens, instead of paying three and one-half per cent monthly charges, are in fact paying five per cent, ten per cent, and even higher monthly loan charges.

On the other hand, the legislators in those states which have faced facts and have dealt with the problem accordingly, know that within their jurisdictions the new plan of regulation, with a fair loan charge geared to the actual expenses and risks of the business, has permitted honest capital to make small loans honorably, has lifted the whole situation out of the mire on to the plane of a legitimate banking service, and has exterminated exploitation, moral usury, and all the untold tragedy that necessity and ignorance have suffered at the hands of unscrupulous cunning and greed.

The small-loans field, because of its unique position in this great social question, is now the battleground upon which the present clash of opinion in the usury controversy is being fought out. On the one hand are the defenders of the past order, dominated by the ancient prejudices about usury, misled by the false belief that a sumptuary law can control the market price of capital, and actuated by a false sentimentality that weeps at the prospect of a changing

order. On the other side are the practical economists, business men, and enlightened jurists armed with scientific arguments based upon a complete array of facts. Both sides seem to be marshaling their forces for the final test of strength. But a new epoch of better social adjustments and better administration of justice is about to emerge from this conflict of opposing theories. Underlying it all can be discerned, at first but dimly, but nevertheless with unmistakable certainty, a half-unexpressed and inarticulate tendency to rely upon basic economic principles, which must inevitably result in a better public understanding of the loan business and a more rational handling of the whole usury problem. Economists have commenced to realize the facts and have planned new reforms.[1] State legislatures have begun to see the results of their past errors and have taken definite steps to correct them. Thus legal science has been accelerated in its forward march of progress and economic science has been enriched in its search for truth.

[1] Dr. Louis N. Robinson, of the Russell Sage Foundation, has been engaged for the last two years making a survey of the small-loan business. For a review of the scope of this work see the *Year-Book of the American Industrial Lenders' Association*, December, 1923, pp. 100–10.

CHAPTER XVI

ADMINISTRATIVE LIMITATION OF LOAN CHARGES ON SMALL LOANS

All the general statutory maximums ordinarily called usury laws, and all the small-loan laws in the United States, are examples of the limitation of interest rates by the action of the legislative branch of government. The non-sumptuary usury laws of England, India, and Germany are typical of the control of interest rates by the judicial branch of government in those fields where there is no market rate of loan charge determined at the margin.

The Massachusetts Small-Loan Law of 1916, however, has by an amendment gone a step beyond all the other types and systems of social control of loans, and provides, within the maximum of three per cent a month, for the first time in this country, or perhaps for the first time in the world, an example of the fixing of limitations on interest rates by the administrative branch of government.

In Section 100, of Chapter 140, of the General Laws of Massachusetts, we read:

> He [the commissioner of banks acting through his deputy, the supervisor of loan agencies] shall establish the rate of interest to be collected, and in fixing said rate shall have due regard to the amount of the loan, and the nature of the security, and the time for which the loan is made; but the total amount to be paid on any loan for interest and expenses shall not in the aggregate exceed an amount equivalent to three per cent a month on the amount actually received by the borrower, computed on unpaid balances; and no licensee or company or association to which sections 96 to 112 inclusive, apply shall charge or receive upon any loan a greater rate of interest than that fixed by the commissioner. No charge, bonus, fee, expense or demand of any nature whatever, except as above provided, shall be made upon loans to which said sections relate.

Under this grant of power the Supervisor of Small-Loan Agencies in Massachusetts, Mr. Frank H. Pope, has already fixed two maximums for small loans. He has decreed that the rate for small loans secured by Liberty bonds shall be not over one per cent per month, and that the rate for small loans secured by real estate shall not be over two per cent per month. On all other loans of this class the statutory maximum applies.

This grant of power is quite significant. It was clearly necessary to give the supervisor of loan agencies this power because of certain reasons. In the first place, it was obviously impossible for a statute to be flexible enough to provide for gradations in classes of small loans according to the elements determining rates of interest. If a statute providing such things were passed, it would have to be revised so often that it was clearly necessary to leave the fixing of rates to an administrative agency of some kind. Furthermore, it is well known that when once a statute is enacted it may take years to get it revised, and often, in the revision, so many amendments and jokers are inserted that when the bill finally becomes a law it is often worse than it was before the revision. It was also clearly necessary to give this power to an administrative agency of government because on the two classes of loans mentioned, namely, loans secured by Liberty bonds and loans secured by real estate, the maximum rate allowed by the Massachusetts statute of thirty-six per cent a year was too high a charge.

In other words, the supervisor of loan agencies, acting as a deputy for the commissioner of banks, has been given the power to classify loans of this type according to the security offered. He has exercised this power by creating three classes, namely:

(1) Small loans secured by Liberty bonds.
(2) Small loans secured by real estate.
(3) All other small loans.

But the law gives other powers. He can classify small

loans also as to the amount of the loan, and the duration of the loan.

It is, therefore, conceivable that under this power a very considerable number of classes for small loans might be designated. The following outline is merely suggestive:

I. Loans Classified as to Security
   1. Secured by Liberty bonds.
   2. Secured by other bonds and stocks.
   3. Secured by real estate.
   4. Secured by personal property left in the possession of the lender.
   5. Secured by a mortgage on personal property left in the possession of the borrower.
   6. Secured by "assignment of wages."
   7. Unsecured loans and other loans.

II. Loans Classified as to Duration
   1. Loans of three months or less.
   2. Loans of from three months to six months.
   3. Loans of longer duration than six months.
   4. Loans made for a long period but paid up sooner than the contract calls for.

III. Loans Classified as to Amount
   1. Loans from $1 to $10.
   2. Loans from $11 to $24.
   3. Loans from $25 to $49.
   4. Loans from $50 to $150.
   5. Loans from $151 to $299.99.

With seven sub-classes of loans as to security, four sub-classes of loans as to duration and five sub-classes of loans as to amount, it is seen that one hundred and forty different classes of small loans might be set up.

Furthermore, while it is evident that thirty-six per cent a year is too high a rate for loans secured by Liberty bonds and loans secured by real estate, it has recently been discovered that thirty-six per cent and even the forty-two per cent allowed under the Uniform Small-Loan Law, are too low for unsecured loans under five hundred dollars.

In 1916, when the small-loan law of Massachusetts was

enacted, the sponsors of the bill sought the advice of Mr. Arthur H. Ham, Director of the Division of Remedial Loans of the Russell Sage Foundation. He is considered to be one of the greatest authorities in the United States upon the subject of rates for small loans. It was upon his recommendation that the rate was fixed at three per cent in Massachusetts. Within six months after the bill became a law, he decided that three and one-half per cent a month was a more reasonable rate, and upon the basis of his findings this rate has become established in all the states which have the Uniform Small-Loan Law.

Relative to unsecured loans under fifty dollars, it has been pointed out recently [1] that there is a question as to whether this three and one-half per cent rate of the Uniform Small-Loan Law is adequate. The data from which the three and one-half per cent rate was fixed came primarily from a study of the thirty-four organizations in the National Federation of Remedial Loan Agencies. All the loans made by these organizations were *secured* loans.[1] Furthermore, most of these organizations confined their operations to pawnbroking. It is clear that on a fifty dollar unsecured loan, the rate should be higher than on a seventy-five dollar or a one hundred dollar loan secured by mortgage or by pledges of personal property, because the risk is much greater where there is no security and because it costs just as much to make a small loan as it does a large one. The expense of dunning the borrower also is much greater on the average on unsecured loans than on secured loans.

In favoring a higher rate than three and one-half per cent a month for unsecured loans under fifty dollars, a Massachusetts report says: [2]

There is always a general idea abroad that, if the licensed lenders lose money and go out of business, it is, perhaps, a good thing.

[1] See Reginald H. Smith, Brief Concerning House Bill 796, March 9, 1920.

[2] Massachusetts Annual Report of the Supervisor of Loan Agencies for the year ending December 31, 1920, Public Document no. 95, p. 8.

This assumes that, when legitimate capital goes out of the field, borrowing ceases. This is untrue. When legitimate capital goes out of the field, the loan shark appears; that is because borrowing is a necessity, and so long as the demand exists, some supply will meet it.

In other words, if loans cannot be made under the law, by licensed lenders, loans will be made outside the law by loan sharks, and the loan sharks will have to charge exorbitant rates to indemnify them against the penalties of the law. The man who wants to borrow fifty dollars to buy medicines for his sick baby, or to pay funeral expenses when there is a death in his family, will gladly pay any price that is asked, to get the money.

Thus it is seen that it is only logical to give the supervisor of small loans the power to classify loans, and to fix rates of interest from time to time as he sees best. In Massachusetts he has an almost perfect accounting system which gives him, at all times, information about the loans that are being made. Incidentally the facts show that the three per cent maximum is operating to drive unsecured loans out of the field.

Furthermore, this power has been used to the advantage of the poor borrower and the arrangement has worked well. It has accomplished things that no statute could accomplish.

In view of these facts, it seems that the administrative official ought to be given the power to fix all maximums. We have seen that the three per cent a month maximum is too low in some cases. Why not let an administrative agency work out the fair rate in every case on the basis of the facts gotten from his records?

It might well be objected that such a plan would give the administrative official too much power. This objection could be met by making him the chairman of an administrative tribunal which could work together to determine fair and just rates. Furthermore, it is perfectly logical and feasible for such an administrative tribunal to sit as

a court to hear complaints of both borrowers and lenders. Such an administrative commission might well have, in addition to the supervisor of loan agencies, four other members, one representing the lenders, another representing the borrowing public, a third an expert accountant, and a fourth an actuary who is an expert in determining the risks involved.

There have already been conspicuous examples of the successful operation of such administrative commissions in other fields. Among these are the Industrial Accident Commissions and the Interstate Commerce Commission. The Industrial Accident Commissions show that much could be done by similar plans in the field of small loans. They have at all times operated to make justice more available to the poor and to save time and expense to thousands of people too poor to take their troubles into court.[1]

[1] See Reginald H. Smith, *Justice and the Poor*, published as Bulletin 13 by the Carnegie Foundation for the Advancement of Teaching, pp. 3, 4, 9, 10, 84, 85, 86, 87, 90, 91, 92, and 95. This gives an excellent account of the successful development of administrative tribunals.

CHAPTER XVII

WHICH BRANCH OF GOVERNMENT SHOULD CONTROL SMALL LOANS IN THE UNITED STATES?

We have now seen that the fixing of statutory maximums for interest rates has been done in different communities by all three branches of government — the legislative, the judicial, and the executive. The prevalent form in the United States is by the statutes of the legislative branch. In England and India, it is done by the courts in remaking contracts and in the influence which their decisions have upon lending operations. In Germany, the judicial branch of government exercises a similar control by declaring that when there is moral usury a contract is void. In Massachusetts the Supervisor of Small-Loan Agencies has been given the power to fix certain rates of interest provided he does not exceed a maximum of three per cent per month.

This brings us up to the problem as to which of these three methods is the most satisfactory to accomplish the elimination and prevention of moral usury in the United States. It has been amply proven that the general statutory maximum is the most unsatisfactory method of all. But the special statutory maximum known as the Uniform Small-Loan Law has accomplished remarkable results in the United States under the administration of able officials. The non-sumptuary usury laws of Germany, England, and India have also accomplished noteworthy results. The control of loans by complete administrative tribunals has never been tried in the United States, although it has been necessary in Massachusetts to allow an administrative official to determine rates of interest under the statutory maximum provision. This chapter will take up the three methods and will attempt, upon the basis of a careful analysis of all the factors involved in each case, to decide which method is the best for use in the United States.

I. The Uniform Small-Loan Law

On the following page are listed the advantages and disadvantages of the Uniform Small-Loan Law. While there are many points against it, the remarkable results it has accomplished prove its value. In fact, it is the only device that has ever actually worked in the United States to eliminate the loan shark from business. This law has a maximum of forty-two per cent a year, which is high enough to attract lenders into the field and enable them to make a fair profit. Yet the forty-two per cent maximum is fixed and rigid and allows no variations for the stages in the business cycle.

Although eleven states have established the three and one-half per cent monthly maximum for interest rates on small loans, the question persists as to whether the rate ought to be higher than that on the very small unsecured loans.[1] Many people, because of the good results accomplished by the small-loan laws, attribute these results to the forty-two per cent maximum without considering whether further refinements of the law might add still more to its social value.

The question naturally arises as to whether forty-two per cent is any more correct than thirty-six per cent. Why not fix the rate at forty-three per cent or forty-seven per cent or fifty per cent? It has already been pointed out that small loans vary widely as to security, size of loan, and as to duration of time. Some loans secured by Liberty bonds should have a rate not over one per cent a month. Other small unsecured loans should be allowed as high as five per cent a month. The fixing of a single maximum rate for all types of small loans is thus seen to have objectionable features as did the fixing of a general statutory maximum for all kinds of loans, including commercial and investment loans. Of course the small-loan maximum of forty-two per cent is much more satisfactory than a maximum of six

[1] See p. 155 above.

I. LEGISLATIVE CONTROL OF CHARGES ON SMALL LOANS

Balancing of Factors

Favorable and Unfavorable to the Plan of the Uniform Small-Loan Law by which the Legislative Branch of Government fixes a Statutory Maximum of 42 Per Cent per Annum (3½ per cent per Month) for all Kinds of Small Loans in General

(Pawnbrokers' loans are often not included in the law.)

Favorable	Unfavorable
1. This plan has in many states driven the "loan shark" out of business.	1. This law still sets up an artificial definition of usury. The ideal law would be aimed direct at moral usury.
2. The maximum is high enough to attract the old lenders in under the law and also to attract new capital.	2. The 42 per cent maximum is fixed and rigid and allows no variations for the stages in the business cycle.
3. The law has saved millions of dollars to the poor people of the states where it is in force.	3. It has been found that unsecured loans under $25 should draw a rate higher than 3½ per cent a month to be profitable.
4. This plan takes away the stigma of "loan shark" from the lender, thus giving him the respect of society.	4. In the case of some small loans such as loans secured by Liberty bonds, one per cent a month is ample interest.
5. In this plan the licensing official has such perfect control by his accounting system that he can immediately check up violations of the law.	5. If maximums are to be fixed they should vary for each class and subclass of small loan, as to duration, security, risks, etc.
6. The penalties for violating the law are sufficiently severe to prevent violations.	6. The statutory maximum can be evaded by means of sales of property.
7. Justice is made less costly to the poor.	7. The 42 per cent maximum is in reality an empirical rate fixed by experience and not on the basis of scientific studies of the risks involved in each type of loan.
8. Many delays in justice are eliminated.	8. The uniform Small-Loan Law has worked well chiefly because of the power and accounting control given to the licensing official.
9. This act virtually eliminates the effect of the old "usury laws" from the field of consumptive loans.	
10. In view of the present popularity of statutory maximums in the United States, this is the best way to make progress toward the repeal of the usury laws.	
11. In time, through the legalizing of the business, enough capital will be attracted into the field so that there will be a true competitive rate.	

Conclusions

1. As an immediate measure, the Uniform Small-Loan Law is helpful and necessary. It gets the desired results.

2. But a statutory maximum like this with no recognition of differences between loans as to risks and security, is not perfect and can still further be improved.

per cent because it is much higher, but an absolutely correct statutory maximum for all varieties of small loans can never be determined. If maximums are to be fixed, there should

be gradations to allow for differences between loans as to security, amount of loan, and date of payment. But the fixing of such maximums for different classes of loans is too complicated to be left to statutory enactment.

Nevertheless, with all its shortcomings, the Uniform Small-Loan Law has proven very valuable. It has made justice more available to the poor by eliminating costs and delays. It has saved millions of dollars to the poor borrowers of this country and has legalized and made respectable a business which for years has operated outside of the law. This legalizing of the small-loan business will probably operate to attract more capital into the field, so that in time a competitive market rate of interest for certain kinds of small loans may be established. But for all these good results the forty-two per cent maximum or the thirty-six per cent maximum should not receive all the credit. These small-loan laws have worked well chiefly because of the administrative powers and accounting control of the small-loan business that have been given to the licensing officials in the various states.

The Uniform Small-Loan Law has also accomplished another desirable result in that it operates virtually as a repeal of the old usury laws in the field of small loans. Since the old usury laws were enacted to prevent and eliminate moral usury, and since moral usury usually occurs in the field of small consumptive loans, there does not seem to remain any important reason for keeping the old usury laws with their general statutory maximums on the statute books.

On the basis of this balancing of the advantages and disadvantages of the new Uniform Small-Loan Law, we can find nothing to controvert the conclusions already arrived at in regard to the law, or the opinion that it should be enacted in every state.

The business man wants to get rid of the old usury laws, but, before that can be accomplished, legislatures must be given a method to eliminate moral usury. The Uniform Small-Loan Law furnishes this method.

II. Judicial Control of Interest on Small Loans

We have already seen that in England, India, and Germany there are no statutory maximums for interest rates, but the courts are given the power, under the non-sumptuary usury laws of those countries, first to determine whether there has been moral usury before taking action in any usury case. In Germany moral usury voids the contract; in England and India, if there has been moral usury, the courts can remake contracts.

It has been suggested[1] that laws similar to these be enacted in the United States, but as yet the plan has never been tried. The plan has many attractive features. Under a non-sumptuary usury law of this kind, whenever a usury trial comes up it is possible to raise the issue of moral usury, whereas under a statutory maximum, which defines usury as the taking of any interest more than the legal limit, the issue of moral usury can never be raised. In these countries, where the courts determine whether there has been moral usury or not, we have the ideal situation, since moral usury and legal usury have the same meaning. The two definitions coincide. This is the most direct way of going against moral usury. The wide powers of the courts are sufficient to thwart all attempted evasions of the law. By giving the court the power to remake the contract, as in England and India, the agreement can be revised and made to be what it would have been if the parties had been in equal bargaining positions. By giving the court power to declare a contract null and void if moral usury is present, as is done in Germany, the rights of exploited borrowers are also safeguarded.

There is little doubt that such a system of judicial control would work well in this country, if it could be adapted to American institutions and traditions. There are, however, a few insurmountable barriers to the adoption of the system which make it improbable that it will ever be in force in this country.

[1] C. J. Bullock, *Introduction to the Study of Economics*, p. 435.

II. JUDICIAL CONTROL OF CHARGES ON SMALL LOANS

Balancing of Factors

Favorable and Unfavorable to the Adoption in the United States of the Plan in Effect in Germany, England and India, by which the Courts First Determine whether there is Moral Usury before Taking Action.

(In Germany moral usury voids the contract. In England and India, if there is moral usury, the court can remake the contract.)

Favorable	Unfavorable
1. This system makes it possible to raise the issue in a law suit of whether there was moral usury. Under a rigid statutory maximum this issue cannot be raised.	1. In 40 states in the United States the judges are elected. This would tend to cause the judge to want to do the popular thing and decisions would go against the lender, thus driving many of them from the field or causing them to operate outside the law.
2. Under this system the legal and moral definitions of usury coincide.	2. In the United States there would also be the probability that juries, when called upon to determine questions of fact, would in most cases find for the poor borrower. This is shown in many cases where corporations have been defendants.
3. This is a direct way of going against the evil of moral usury.	3. It is against American legal principles for a court to remake a contract. The Constitution says that courts shall do nothing that will tend to impair contracts.
4. The wide powers of the courts will control all kinds of attempted evasions of the law.	4. In the United States justice for the poor is notoriously costly and slow. There would be long delays. It would often be many months before the case would come up. The time wasted in court would often be worth more than the amount in dispute.
5. By enabling the court to remake the contract (as in England and India) the agreement can be revised and made to be what it would have been if the parties had been in equal bargaining positions. 6. By giving the court power to declare the contract null and void (as in Germany), if there has been moral usury, the rights of the exploited borrower are safeguarded.	5. There is an even better system than allowing courts to determine what is a proper interest charge. It is the control by administrative tribunals.

Conclusion: It would be inexpedient to adopt this form of judicial control of interest rates on small loans in the United States.

In at least forty of the states of the United States, the judges who would have jurisdiction over usury cases are elected. This would tend to cause the judge to want to do the popular thing and court decisions would in many cases go against the lender, thus driving him from the field or causing him to resort to evasions.

There would also be the probability that juries, when called upon to determine questions of fact, would in most

cases find for the poor borrower. This is shown in many cases where corporations have been defendants.

Furthermore, the system of England and India could not be adopted in the United States, because it is against American legal principles to give courts the power to remake contracts. The federal Constitution provides that courts shall do nothing to impair contracts.

The chief objection to the plan of allowing courts to determine what should be proper interest rates on small loans is that in the United States justice for the poor is notoriously slow and costly. There would be long delays. It would often be many months before the case would come up for trial. The case might require several days in court. There would be innumerable court costs and lawyers' fees. The total expense and bother of taking a case involving a loan of fifty to seventy-five dollars to court would probably cost the borrower more than the amount of the loan. Although the court-houses are open and equity courts are in session with judges and officers in attendance, all this may be of no avail to the poor man who cannot afford to pay five dollars for service of process and entry fee and ten dollars to an attorney to draw, file, and present the necessary bill of complaint, and who further cannot afford to take several days off from his work to attend to such business.[1] Many such cases have required more than a year to reach a decision.

Furthermore, there is an even better system than allowing courts to determine what is a proper interest charge. It is the control by administrative tribunals.

We can therefore conclude that it is not only well-nigh impossible, but also inexpedient to adopt this form of judicial control of interest rates on small loans in the United States.

[1] See Reginald H. Smith, *Justice and the Poor*, published as Bulletin 13 of the Carnegie Foundation for the Advancement of Teaching, p. 11.

III. Control of Interest on Small Loans by an Administrative Tribunal

In Chapter XVI it was suggested that the control of interest rates on small loans by an administrative official, as is the case in Massachusetts under the Massachusetts Small-Loan Law, might be extended so that the Supervisor of Loan Agencies might be made the chairman of an administrative tribunal composed of several other members, and that this administrative tribunal should be given complete power to classify all types and varieties of small loans and determine and revise maximum rates of interest for the particular types of loans from time to time as found expedient.[1]

Such a plan may be objected to on several grounds. In the first place, it has never yet been tried out in any state. Such administrative control as is exercised by the Supervisor of Loan Agencies in Massachusetts is limited by the statutory maximum of the Small-Loan Law. Such a plan will take cases out of the courts. It is extra-legal. It entrusts justice to laymen. It takes cases out of the hands of lawyers. In order to get well-qualified men on the commission, salaries would have to be paid which would make the cost of supervision of small loans inevitably more expensive than it would be in the absence of such an administrative tribunal. It may be objected also that such a plan would give the tribunal too much power.

Nevertheless, the plan has several advantages which merit attention. With experts on the commission, rates could be determined upon a scientific basis with regard to each different type of security, type of loan, and date of payment. The rate could be easily changed if found to be wrong in any case. A statutory maximum is very difficult to get changed. It took one hundred and thirty years to get the New Hampshire usury law repealed, and may take another century to get the New York usury law repealed.

[1] See pp. 156–157 above.

Furthermore, the rates could be varied with the stages of the business cycle if such variations be found necessary.

Mr. G. W. Kehr, National Secretary of the American Industrial Licensed Lenders' Association, has this to say about the changes in risks in small loans due to the stages in the business cycle: [1]

The small-loan business is affected by industrial conditions. During the recent war period of prosperity the demand for small loans was not as great as it is now (1921), but because the people had the money they were in a position to pay the loans which they took out; but now the demand is much greater and our loan companies are taxed to the limit to provide funds to meet the situation. The loans at this time are most hazardous, for the reason that so many people are out of employment and unable to pay the loans back as they are arranged in small weekly or monthly payments. This, of course, results in heavy losses for the loan companies.

Miss Dorothy Clair, secretary of the Legal Reform Bureau, writes as follows: [2]

In a great industrial country like ours there are cycles of business depression bringing a large amount of unemployment and there are periods of industrial prosperity where almost any man can get a job. At a period of decline in industrial employment, it is impossible for a loan manager to anticipate how far the unemployment will go. A loan manager may lend money to a worker having seemingly steady employment and yet the worker may, through no fault of his own, lose his job and be unable to meet his payments. The loan manager cannot foretell whether the unemployment will be temporary or of long duration.

A money-lending concern in Manchester, New Hampshire, had unusually severe losses because of a textile strike which lasted two months. When this ended, the workers went back to work again, but within a short time another strike was called. This played havoc with the loan company. The same thing happens from time to time in the coal districts of Pennsylvania and Indiana.

In Richmond, Norfolk, and Baltimore particularly, as well as at Bridgeport, Connecticut, Portsmouth, Virginia, and Newport News, nearly any worker was good for a loan during the war prosperity, but after demobilization, skillful and competent workers lost their jobs, and as a result, some of the loan offices in those cities have not made any money for years.

[1] From a letter by Mr. Kehr to the author, dated August 16, 1921.
[2] From a letter by Miss Clair to the author, dated June 14, 1924.

This fact, that risks vary with the stages of the business cycle, seems sufficient to warrant the taking of part of the control of small-loan charges away from rigid statutory maximums.

Another advantage of this plan of control of interest rates on small loans by administrative tribunals is that it safeguards the interests of lenders as well as those of borrowers. Proper checks could easily be placed upon any abuse of power by members of the commission.

Furthermore, the Supervisor and his commission could be given full power to sit as a court and to determine whether moral usury exists in some individual cases. In this way all the advantages of the systems of judicial control of interest rates of small loans as in effect in Germany, England, and India could be secured without their disadvantages. Moreover, this system gives justice to all on equal terms, and eliminates numerous delays and fees that formerly kept poor people from seeking justice in the courts. The evil of contingent fee cases is also eliminated.

In Massachusetts where the Supervisor of Small-Loan Agencies has been given certain administrative powers to fix interest rates, the power has been rightly used to the advantage of the borrowers. This could not have been accomplished by statutes. It can safely be assumed, therefore, that this power could well be extended as has been outlined, and that such extensions of power would be rightly used to the advantage of the public and to the elimination of moral usury.

This development is in line with other similar developments, such as the Industrial Accident Commission and the Interstate Commerce Commission. Mr. Reginald H. Smith, of the Boston Bar, in commenting upon the rapid growth of the number of administrative tribunals in the United States, has this to say:[1]

If one were compelled to state the most important experiment in the administration of justice made in the twentieth century, the

[1] Reginald H. Smith, *Justice and the Poor*, published as Bulletin 13 of the Carnegie Foundation for the Advancement of Teaching, p. 83.

III. ADMINISTRATIVE CONTROL OF CHARGES ON SMALL LOANS

Balancing of Factors

Favorable and Unfavorable to a Plan by which the Official who Supervises Small-Loan Agencies shall Sit as a Chairman of a Commission or Administrative Tribunal, which shall be Given the Power in Addition to the Powers already Given under the Small-Loan Laws to the Licensing Official, to Classify the Different Types of Small Loans and Fix and Revise the Rates of Interest for each Type of Loan from Time to Time as Found Necessary

Favorable	Unfavorable
1. With experts on the commission rates could be determined upon a scientific basis with regard to each different type of loan and kind of security.	1. This plan has never yet been fully tried out in the field of loans.
2. The rate could be easily changed if found to be wrong. A statutory maximum is very difficult to get changed. It took 130 years to get the New Hampshire usury law repealed.	2. This plan takes cases out of the courts. It is extra-legal. It entrusts justice to laymen. An anti-lawyer plan.
3. The rates could be varied with the stages of the business cycle if that is found necessary.	3. It seems to give the men on the administrative tribunal too much power.
4. Proper checks could be placed upon any abuse of power by the commission.	4. This is an expensive plan. All the commissioners will have to be paid by the state. The expense is so great as to outweigh most of the advantages except in large and densely populated states.
5. The interests of the lenders are safeguarded under this plan.	
6. The Supervisor and his commission could have full power to sit as a court and to determine whether moral usury exists in any cases.	
7. Under this plan justice is made available to the poor at the lowest possible costs and with least delay.	
8. In Massachusetts it was found necessary to give the Supervisor power to fix rates in certain cases. It was also found that this power was rightly used and administered to the advantage of the borrower and the promotion of justice to the poor. This could not have been done by the unwieldy means of legislative enactments.	
9. The evil of contingent fee cases is eliminated.	
10. This development is in line with other similar developments such as the Industrial Accident Commissions and the Interstate Commerce Commission.	

Conclusion: The ideal situation is to enable all classes to obtain equal protection under the laws. An administrative tribunal operates to make justice more available to the poor. But in view of the heavy expense of such an elaborate system of machinery, it is evident that in most of the states it can never be fully adopted. Yet in densely populated states it will be advantageous to modify the Uniform Small-Loan Law along the lines indicated by the modifications made in Massachusetts.

answer would unhesitatingly be the attempt to secure justice through administrative tribunals. Such tribunals have sprung up with amazing rapidity, they have taken over an enormous amount of litigation formerly handled by the courts, and the law concerning administrative justice is the most rapidly growing branch of law in our entire jurisprudence.[1]

Some of the advantages of the administrative tribunal are due to the fact that it occupies an extra-legal position.[2] It is closely analogous to the rise of equity,[3] with the exception that, instead of entrusting justice to priests in place of judges, our recourse has been to laymen.[4] But it seems certain that administrative tribunals must ascertain and administer their justice according to law, and it is likely that they will ultimately become part of the regular judicial system.[5]

The conclusion may now be drawn upon the basis of the foregoing survey of factors and considerations that the suggested plan of having an administrative tribunal fix and revise interest rates on small loans from time to time as is found expedient, and sit as a court in certain cases, would be desirable in the United States because of its many advantages. It would be better than the legislative control of interest rates as exercised under the Small-Loan Law, and it would be better than the non-sumptuary usury laws of Europe and India under which the courts decide whether contracts shall be enforced or not; that is to say whether or not moral usury is present.

Yet an administrative tribunal is not widely different from a court. In one sense it is a court — a court of spe-

[1] Mr. Smith has here expressed ideas for which he gives credit to Dean Pound's *Report to the President of Harvard University* (1915–16), p. 1.

[2] Roscoe Pound, *Organization of Courts*, American Judicature Society, Bulletin VI, p. 4.

[3] *Ibid.*, p. 5.

[4] R. H. Smith, *Justice and the Poor*, p. 91.

[5] Roscoe Pound, *Report to the President of Harvard University* (1915–16), p. 2. See also Roscoe Pound, "Preventive Justice and Social Work," in *Proceedings*, National Conference of Social Work (1923), pp. 151–63.

cialists administering justice upon the basis of experience and scientific knowledge. In a larger sense it is really a part of our judicial system even if it is extra-legal.[1]

In discussing the three different branches of government and contrasting the different methods of dealing with the problem of eliminating moral usury, there is a danger that one may forget that, after all, the three different departments of government are all parts of one government, and that it is difficult to draw lines of demarcation in many cases between the three branches.

In answer to the question as to which branch of government should control the charges for small loans in the United States, it can now be concluded that:

1. Neither of the systems of judicial control in effect in England, India, or Germany would at this time be possible or suitable in the United States. Of course, if our system of statutory maximums should in some way be made unconstitutional, and if a federal law could be enacted establishing such judicial control, the way would be made clear for such a change.

2. The ideal system of control will be by an administrative tribunal with powers to fix and revise the charges on different types of small loans from time to time as found expedient, and with power to sit as a court in such cases as may seem to require this procedure.

3. When one considers the expense and difficulties to be overcome in setting up the elaborate machinery contemplated under this suggested scheme of a complete administrative tribunal, it becomes evident that in most of the states it can never be adopted in full. At best it will be a very long time before some states will even consider it. But in a few of the more densely populated industrial states it seems likely that the Uniform Small-Loan Law, as now in force, may be amended in various ways to extend

[1] Some of the dangers and limitations of administrative justice are pointed out by Mr. R. H. Smith in his article "Administrative Justice," 18 *Illinois Law Review*, pp. 211–24.

the administrative control of loan charges as has been done in Massachusetts, and thus by gradual steps approach toward the ideal system of the complete administrative tribunal. Indeed, if Massachusetts had a proper maximum loan charge, its present law would stand as very nearly an ideal statute under present conditions.

4. Since the Uniform Small-Loan Law with its excellent administrative features has already been enacted in a score of states and is accomplishing remarkable results, it is desirable that the campaign to get this law enacted shall be continued so as to have it adopted in as many states as possible. Whenever it is enacted in a state, it operates as an entering wedge to destroy the old usury laws. It whittles away the scope of these old general statutory maximums and takes away the only pretext that legislators have for keeping them on the statute books.

CHAPTER XVIII

CONCLUSIONS

THE purpose of this study, as was announced at the beginning, was to examine critically certain representative and typical state laws, which were enacted with the intention of fixing general maximums for interest rates, in the light of generally accepted economic laws, in order to discover wherein the legislators who framed and enacted these statutes transgressed fundamental principles; and to suggest methods and modes of procedure by which the present situation may be improved to the advantage of the borrower, the lender, and the general public.

The immediate occasion for the study was the fact that in recent years the attention of business men has been focused upon the state usury laws because of their proven futility to control the market rate of interest, and because of the numerous mischiefs caused by such statutes in the field of business relations.

But, although the immediate problem arose in the field of business relations, it was thought best to approach it from several different points of view, taking account of the fact that borrowers want to get money at reasonable rates, lenders want to get the market price for their money without breaking laws, the small borrower for consumptive purposes wants to be freed from the clutches of the loan shark, farmers want to get mortgage money at low rates, bankers and financiers want the public to become better acquainted with the basic principles governing the movements of interest rates so that the fallacy of a sumptuary law to govern the price of money may be realized, and the legislator wants to know what is wrong with the usury laws and how laws can be framed which will eliminate the

evils that have arisen out of lending operations. Whether the usury laws are inexpedient or not depends to a great extent upon the points of view of those interested.

It was believed that, if the problem were approached from the background of its historical development and examined from all these various points of view, in the light of demonstrated and generally accepted principles of economics, jurisprudence, and political science by which it is possible to test the expediency of present developments, conclusions could be drawn which would be helpful in clearing up the present confusion of thought upon the subject in the public mind and which would prepare the way for further progress in improving the situation. It was desired that the study should be a broad historical survey, and an acute economic interpretation of the various phases of the problems of statutory maximums for interest rates.

In the first two chapters it was seen that, although the problem must first be approached as a question in economic theory, it is more than an abstract problem. From a general survey of the general economic, social, and legal setting in which the problem of usury laws is located, it was shown that merely proving that the usury laws are futile and mischievous does not solve the business man's problem. The legislator who makes the laws also has a problem which must first be solved before the old usury laws can be repealed. From a survey of interest laws with respect to their social purpose, it was seen that the final problem to be solved is how to prevent moral usury. Under the typical American usury law, with its rigid legal definition of usury, the issue of moral usury has been relegated to the background.

In Chapter II it was seen that this study does not necessarily involve the problem of the direct control of Federal Reserve Bank discount rates by state usury laws, since these rates are not subject to state laws. The danger of usury laws interfering with central bank rates was ex-

plained and illustrated by reference to the case of the Bank of England during the period 1796–1820, during which the bank was compelled to suspend specie payments.

In Chapter III a survey was made of the present status of usury laws in the United States. The technical points of the law of usury were summarized. It was here seen that the typical American state usury law is a general statutory maximum for all interest charges on all kinds of loans without regard to duration, security, amount, or risks of different types of loans. Here it was seen also that such laws were copied indirectly from ancient and medieval laws. The theory of a usury law was stated, namely, that such a law is intended to protect the borrower from extortion where he is in a necessitous condition. This is the same as saying that a usury law is intended to prevent moral usury. While most of the other commercial nations of the world have abolished such usury laws, this type of legislation is now increasing in the United States.

In Part Two a brief historical survey of arguments for and against usury laws from ancient times to the present was presented. It was seen that in primitive communities, laws prohibiting interest were perhaps justified, but that with the coming in of commerce and industry it became necessary to legalize interest. The age-long conflict between the church authorities and economic theory was summarized. Some of the arguments of Aristotle and the canonists were given which were later overthrown by Molinæus, Calvin, Salmasius, and Turgot.

In Chapter X it was seen that most of the arguments against general statutory maximums for interest rates naturally group themselves under four heads as follows:

1. General statutory maximums are based upon the false assumption that the costs of making all kinds of commercial, investment, agricultural, and consumers' loans are the same, thus ignoring differences in types of loans, kinds of security, duration of loans, sizes of loans, etc.
2. General statutory maximums are powerless to regulate and control the market rate of pure interest.

3. General statutory maximums are mischievous and detrimental in their effects upon business relations.
4. General statutory maximums defeat their own social purpose. A usury law is intended to eliminate and prevent moral usury but its rigid legal definition of usury stops all inquiry into what should be fair rates for different types of loans. It relegates the issue of moral usury to the background.

In this chapter it was also pointed out that by approaching the problem from the point of view of the legislator the real issue is finally faced. If we can help the legislator accomplish his social purpose, which is to eliminate moral usury, we have made real progress toward a solution. He wants to do his part in enacting laws which will prevent the taking advantage by the lender of the necessitous condition of the borrower to get him into hard bargains and extort from him unduly high loan charges. It was here seen that legislators hesitate to repeal the old usury laws because the theory of the laws is correct even if a general statutory maximum is wrong in principle. If such laws worked only in rare cases, they were regarded as better than nothing.

As we look back over the history of economic thought on usury laws, the name of Jeremy Bentham stands out above all others as the man who did the most to clear up the problem. He clearly proved that usury laws are both powerless to control the market rate of interest and are mischievous in their effects. But he failed to prove his contention that society should be left entirely free to make loan contracts without legal restraints. He avoided the problem of how to prevent moral usury and covered up his evasion of the issue by juggling definitions of the word usury.

Convincing the economists that usury laws are futile and mischievous does not convince the legislator that they should be repealed. Our lawmakers will be ready to repeal the usury laws only when they are shown that there is a more effective instrument for preventing moral usury. Thus the problem of the business man becomes the problem of economic society in general.

Since modern commerce and industry are conducted to a great extent on borrowed capital, and since nearly all financial relations are credit relations where loan charges, including interest, are paid and received, the problem of usury laws goes to the very foundations of the structure of commercial and financial society.

In Chapter XI the recent legislative enactments in California and New Hampshire were reviewed. This was valuable in showing how legislatures have been deciding such questions. Studies of the actual arguments employed in cases of this kind reveal the kind of tactics which must be used in the future in order to secure constructive legislation. In both cases there were errors in reasoning. The California statute was enacted in 1918 because of misunderstanding the real issues involved, while the New Hampshire law was repealed by cleverly playing up the interests of a particular class of people.

In Chapter XII it was shown how the usury laws have operated in the field of agricultural loans by comparing the state statutory maximums for loan charges with actual rates charged on farm loans in all the states as revealed by questionnaires sent out to banks by the United States Department of Agriculture. It was here demonstrated that the usury laws operate in actual practice as Irving Fisher has demonstrated they would operate by pure economic theory. The usury laws, although operating in most cases to keep the rate stipulated in a loan contract within the limits set, are powerless to prevent numerous other devices from being used by the parties to a loan, such as bonuses, commissions, requiring balances, and other methods. This was particularly well demonstrated in a very interesting way by a comparison of the rates actually charged in North Carolina and South Carolina.

This chapter was not unmindful of the present problems of the farmer. Farmers all over the United States are very desirous of getting lower rates of interest on farm loans. It was pointed out that, although usury laws will not

accomplish this desired end, it can be attained and is already on its way to be attained by our new national agricultural credits systems, which include such devices as credit unions, farm loan associations, tax exempt land bank bonds, etc., which operate to promote better farming methods, greater community solidarity, greater ease of movement of eastern capital into agricultural loans, lower risks to bankers, and higher credit standing to farmers.

In Chapter XIII further recent evidence was given to substantiate the arguments against general statutory maximums for loan charges. Here it was seen that the New York usury law is being continually evaded and transgressed, and that these evasions and violations cannot be prevented. The investigations of John Skelton Williams, showing that one third of the American national banks have been guilty of legal usury, reveal the fact that in rural communities small banks must perform the functions of the lenders who make consumptive loans which involve high risks of loss. A study of the movements of interest rates over a fifty-year period proved that the usury laws will be "obeyed" only when the market rates of interest happen to be lower than the legal maximums. The findings of the Untermyer investigations in New York also showed the prevalence of evasions of the usury laws in the field of mortgage loans.

A review of the non-sumptuary usury laws of Germany, England, and India revealed how those countries have taken steps to eliminate moral usury by placing the control of the situation in the hands of the courts.

In Chapter XV the progress of American small-loan legislation was briefly surveyed. Here the origin of the "loan shark" was traced and the measures taken to eliminate the evil were reviewed. It was shown how modern industrial society began to demand a "poor man's bank," and how this demand was met by the various lenders of the United States up to the time that it was realized that the old usury laws were inadequate to protect the borrowing workingman.

The Uniform Small-Loan Law was then explained and the results that it has accomplished were summarized. Incidentally, an account was given of the recent enactment in April, 1923, of the Uniform Small-Loan Law in Rhode Island.

The constitutionality of the law was then discussed in connection with the recent Minimum-Wage Law decision by the United States Supreme Court. Several decisions and dicta were cited to show that there is very little likelihood that the constitutionality of statutory maximums for interest rates will be overthrown.

Several economic considerations in regard to small-loan laws were next discussed. It was shown that, even if a general statutory maximum is clearly wrong in principle, the new special statutory maximum known as the Uniform Small-Loan Law is right in principle for the following reasons:

1. It recognizes differences in costs of making loans.
2. It operates only in the field of loans where moral usury takes place, namely, the field of small consumptive loans.
3. It can cause no mischievous effects in the field of commercial and investment loans since it operates only in the field of consumers' loans.
4. It interposes the police power of the state to strengthen the bargaining position of the weak borrower.
5. It can actually operate to limit excessive charges in this field because these loans are in individual cases and the charges are not determined at the margin as are pure interest rates. By strengthening the bargaining position of the borrower he is placed upon a better footing.
6. It aims to establish a legal definition of usury which will quantitatively approximate the true definition of moral usury. Its maximum has been scientifically worked out for this purpose.
7. It has been tried out and found to be remarkably effective in getting results.
8. It is strengthened by the addition of administrative machinery to make it effective.

Finally this chapter pointed out that the Uniform Small-Loan Law is in line with the present-day movement in

legal science toward the individualization of the application of legal precepts and signalizes an advance in progress, not only in economic science, but also in the science of law.

In Chapter XVI a study was made of the powers given to the Supervisor of Small-Loan Agencies in Massachusetts by which he has been enabled to fix and revise loan charges for different types of loans. It was seen that this arrangement marks a further improvement in the Small-Loan Law, and is another step forward in the individualization of the application of legal precepts.

In Chapter XVII an attempt was made to answer the question as to which branch of government should control the charges for loans where moral usury is likely to arise because of the unequal bargaining positions of borrowers and lenders. It was pointed out that, although a fixed special statutory maximum has its weak points, the plan in operation under the Uniform Small-Loan Law has accomplished excellent results where wide powers have been given the supervising officials in the matter of bond requirements, penalties, licenses, and complete accounting control. But it was further seen that in this country, where some forty states elect their judges, where justice is notoriously slow and costly to the poor, and where numerous delays discourage the poor litigant, either of the forms of judicial control in effect in England, India, or Germany would not be suitable at the present time. It was seen that a system of control by administrative tribunals would be the most perfect system to meet the needs of the situation, but that such a system would be so expensive and difficult to get established that most states will never adopt it. The chapter concluded by recommending the system of control set up by the Uniform Small-Loan Law as the best solution to the problem of preventing and eliminating moral usury. It can be amended in various ways from time to time as found necessary so as gradually to approach toward the ideal system of the complete administrative tribunal.

General Conclusions

The general conclusions drawn by this study may now be summarized as follows:

I

In primitive tribal society where the productive employment of capital was practically unknown, the prohibition of interest in many instances may have been justified.

II

As commerce and industry developed and people began to borrow capital for productive purposes, it became necessary and proper to legalize interest.

III

The typical state usury law now in force in forty-two of the states of the United States, which, when enacted, fixed a general maximum limit for interest on all kinds of loans regardless of the purposes of loans or kinds of security, should be repealed. Such a statutory maximum is powerless to control the market rate of pure interest, is mischievous and detrimental in its effects upon business relations, and does not recognize the fact that the loan charge may vary with the duration, amount, and security of the loan.

Such a law also sets up a misleading legal definition of usury, namely, that it is the taking of a greater interest than the law allows, and this definition focuses attention upon an issue which is not the true issue. Although such laws were intended to prevent moral usury, the establishing of this legal definition at maximums of from six to twelve per cent, as is done by the American usury laws, tends to defeat the social purpose of the laws. It declares some loans to be usurious which we know cannot be usurious in the true sense of the word, and this false legal definition of usury makes it impossible in a usury trial to bring up the issue of true usury.

IV

Under the modern capitalistic system, where there is a free interplay of economic forces and where the rate of pure interest is determined at the margin, the lender will get approximately just what his capital earns. The rate of interest stipulated in a loan, or contractual interest, under such circumstances tends to approximate natural or implicit interest. Thus, in a highly developed commercial and industrial commonwealth, statutory maximums for interest rates can only have bad effects in the field of productive loans.

V

But in the field of consumers' loans or loans for consumptive purposes, where the borrowers are usually ignorant and in immediate need, they are likely to be willing to accept any terms that the lenders ask. In this case there is such a glaring discrepancy in the bargaining positions of the parties that some sort of social control is needed to prevent the lender taking undue advantage of the borrower.

VI

In addition to locating the possible existence of true usury in the field of consumers' loans, we can still further limit the location of its occurrence. True usury or moral usury, which is the evil that a usury law is designed to prevent and eliminate, is the result of this inequality of bargaining positions of the parties to a loan. We have defined it as the overreaching or taking advantage by the lender of the necessitous situation and difficulties of the borrower (*"die habsüchtige Ausbeutung der Noth"*) to get him into a hard bargain. On this basis it is clear that true usury takes place only among the very poor and only in the field of small loans, for no person goes out to borrow $1000, or

even $500, because of his personal or family necessities. Such loans are typically from $25 up to $100.[1]

VII

The maximums of from six to twelve per cent, as provided by the state usury laws in forty-two states, were too low to permit lenders for consumptive purposes to operate at a profit. Persons desiring to make such loans at a profit were compelled to operate in violation of the usury laws. This made it necessary to enact new legislation of the type of the Uniform Small-Loan Law, thus taking out of the control of the old usury laws the very class of loans which the usury laws were expected to control to prevent moral usury, so that in any state, wherever the Uniform Small-Loan Law has been enacted, there is no longer any social reason for the existence of the old usury laws.

VIII

Although the ideal way to define moral usury is qualitatively, it is, nevertheless, true that, since moral usury is

[1] This trend in economic theory is paralleled by a similar trend in legal theory. In Southern Life Ins. Co. *v.* Packer, 17 N. Y. 51, 53, the court explained why corporations are not allowed to plead usury in New York as follows:

"These laws were originally based upon the assumption that the needy borrower was in some degree in the hands of the lender. Government has therefore assumed that it was a duty incumbent upon it to protect the former against the rapacity of the latter by adequate pains and penalties. In regard to natural persons, subject to the contingencies of business, often with little or no capital to start with, these considerations might apply with great force; but in regard to corporations organized for the purpose of concentrating in one undertaking, the contributions of a large number of individuals until the aggregate shall amount to the capital supposed to be requisite for the successful prosecution of such undertaking, the legislature may well have assumed that no such protection was necessary; that if corporations thus organized become borrowers it would not be from necessity, but voluntarily to enable them to carry forward some enterprise which afforded a reasonable expectation of profits sufficient to enable them to repay the necessary interest without loss or sacrifice."

I would extend this theory still farther to include not only corporations, but all borrowers except in the field of consumers' small loans.

always an extortionate charge for a small loan of money for consumptive purposes, it is reasonably practicable to define usury quantitatively by statute. This is what the old usury laws attempted to do by guesswork, and what is now being done on a scientific basis by the Uniform Small-Loan Law. The three and one-half per cent monthly maximum is not a perfect quantitative measurement of the evil, but for practical purposes it has been found to be satisfactory.

IX

The legal theory of a usury law or of the Uniform Small-Loan Law is in accordance with economic theory. Furthermore, since it is not out of harmony with the doctrine of freedom of contract which has grown up in recent years, it is in practically no danger of being declared unconstitutional.

X

The new Uniform Small-Loan Law is in line with the present-day movement in legal science toward the individualization of the application of legal precepts.

XI

The general legal theory, which apparently sets up the notion that a general usury law governs in the field of commercial and investment loans, is in error. Such a theory runs counter to the fundamental economic laws of interest.

XII

There is no problem at present as to the direct control of Federal Reserve Bank discount rates by state usury laws. Federal Reserve Banks may rediscount at whatever rate they wish and are not subject to state usury laws.

XIII

If a federal law were passed to limit the maximum rate which could be charged by the central banks and which

would hold that a rediscount was subject to such a law, then the power of the Federal Reserve System to use its rates to control the economic situation in times of inflation would be seriously weakened. Both the Bank of England and the Bank of France have had this trouble with national usury laws in the past.

XIV

Banks in rural districts, where they perform the functions of small lenders and pawnbrokers in making small consumptive loans, should be free to charge rates comparable to rates charged by such small lenders and in such cases should not be thought of as usurers.

XV

Government questionnaires sent out to bankers all over the United States conclusively demonstrate that the old usury laws are powerless to regulate the market rate of loan charges on commercial, investment, and agricultural loans.

XVI

The present-day problem of the farmers of the United States as to getting lower interest rates on farm loans can never be solved by usury laws, but can be solved and is now on its way to a solution by the new federal agricultural credits systems and their excellent devices for lowering risks on loans, improving the credit standing of farmers, promoting the flow of capital into farm loans, and building up the economic solidarity of rural communities.

XVII

All devices which tend to whittle away the old usury laws or to render them nugatory are justified where prejudice still keeps them on the statute books. Some of these devices are: forbidding corporations to plead usury; taking bank loans out of the control of the statute; taking call

loans out of the control of the statute; enacting the Uniform Small-Loan Law; and abolishing or weakening the penalties for violating the law.

XVIII

The extension of the administrative powers of the Supervisor of Small-Loan Agencies in Massachusetts so that he can now fix and revise rates of charges for small loans from time to time, and the successful employment of these powers have shown that the plan could be further extended even to the point where all types of small loans would be so regulated.

XIX

Neither of the systems of judicial control of loan charges, in effect under the non-sumptuary usury laws of England, India, and Germany, would be possible or suitable in this country at the present time.

XX

The ideal system of control of loan charges will be by an administrative tribunal with powers to fix and revise the rates on different types of loans from time to time as may be found expedient, and with powers to sit as a court in cases as may be found necessary.

XXI

At best it will be a long time before any state will consider setting up the elaborate machinery contemplated under such a system of administrative tribunals because of the expense and difficulties involved. But in a few of the states it will be well to amend the Uniform Small-Loan Law as now in force so as to extend the administrative control of loan charges as has been done in Massachusetts, and thus by gradual steps approach toward the ideal system of a complete administrative tribunal.

XXII

The problem of the usury laws, with which this study started, will be solved only when legislators are given the best means of preventing and eliminating moral usury. Since the Uniform Small-Loan Law with its excellent administrative features has already been enacted in a large number of states and is accomplishing remarkable results, it is desirable to continue the campaign to have it adopted in more states. This is an important step in the solution of the problem, for whenever enacted the new law operates as an entering wedge to destroy the old usury laws. It whittles away the scope of these old statutory maximums and takes away the only pretext that legislators have for keeping them on the statute books.

XXIII

The old general usury laws, which are thus being gradually displaced and rendered inoperative, should nevertheless be repealed. They remain to interfere with commercial and financial relations.

XXIV

When legislators come to a full realization that the legal theory and economic purpose of a usury law is to eliminate moral usury; that the old usury laws could never accomplish this because of their defects; that moral usury occurs in nearly all cases in the field of small consumptive loans; that this evil can be practically eliminated from any state by the enactment and enforcement of the Uniform Small-Loan Law; that the old usury laws are detrimental and mischievous in their effects; and that lower interest rates for farmers can be actually attained by far more effective methods than usury laws — when this shall have come to pass, then the day of the repeal of these old anachronistic general statutory maximums cannot be far distant.

APPENDICES

APPENDIX A

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APPENDIX B

EXTRACT FROM THE REPORT OF THE COMMITTEE ON THE USURY LAWS, LAID BEFORE THE HOUSE OF COMMONS IN 1818

"The laws against usury," says Mr. Holland, partner of the house of Baring, Brothers and Company, and one of the best informed merchants in the country, "drive men in distress or in want of money to much more disastrous modes of raising it than they would adopt if no usury laws existed.

"The landowner requires capital to increase his live stock or improve his land or for any other purpose at a period when the government is borrowing money at above five per cent or when the funds give a greater interest than five per cent; no one will then lend to the landowner because the money is worth more to the lender than the law allows him to take; the landowner must therefore, either give up his improvements or borrow money on annuity interests on much more disadvantageous terms than he could have done if no law existed against usury.

"The man in trade in want of money for an unexpected demand or disappointed in his returns must fulfil his engagements or forfeit his credit. He might have borrowed money at six per cent but the law allows no one to lend it to him and he must sell some of the commodity he holds at a reduced price in order to meet his engagements. For example he holds sugar which is worth 80s. but he is compelled to sell it immediately for 70s. to the man who will give him cash for it and thus actually borrows money at twelve and one half per cent which had the law allowed him, he might have borrowed from a money lender at six per cent. It is known to every merchant that cases of this kind are common occurrences in every commercial town and more especially in the metropolis.

"A man in distress pays more interest owing to the usury laws than he would do if no such law existed because now he is obliged to go to some of the disreputable money lenders to borrow as he knows the respectable money lender will not break the laws of his country. The disreputable money lender knows that he has the ordinary risk of his debtor to incur in lending his money, and he has further to encounter the penalty of the law for both of which risks the borrower must pay."

APPENDIX C

MASSACHUSETTS SENATE No. 66

PETITION FOR THE REPEAL OF THE USURY LAWS, MARCH 4, 1834

The undersigned, citizens of Boston, having long experienced the inconveniences arising from the existing Usury Laws of Massachusetts and being persuaded that the Honorable Legislature will, whenever the subject is properly brought before them, provide an adequate remedy for the evils complained of, have deemed it suitable and proper to appear as petitioners before that honorable body, setting forth in their petition the inconveniences to which the present laws give rise and praying such a modification of those laws as will, in their opinion remove the evil.

We, your petitioners would therefore respectfully represent — that, in our judgement, the existing Usury Laws, so far as they limit the rate of interest, are founded on erroneous principles, and are at variance with the commercial spirit of the age. We think that every article of human traffic, whether money or any other thing, is alike subject to fluctuations of value, and that consequently, the market price of them all, is constantly liable to change. We think that the price of money or more properly speaking, the price of its use, not less than the price of lumber, corn, tobacco, cotton, or any other great commercial staple is and must be regulated by the extent of the demand in the market and that every attempt to fix the value and render the price of either of these articles invariable is not only vain but wholly unjust; and that it is, in the case of all these commodities, an equal infringement of private rights.

We are of the opinion that six per cent per annum is not the highest value to which money rises in the course of business, any more than it is the limit of profits made by traffic in any other commodity. But on the contrary, that whenever the use of money, in the regular course of business, produces a large amount of profit, the value of that use is proportionately increased; and that, at such times and at all others when money is scarce and the demand for it great as well as in cases where the risk of lending is very much increased, the real value of monied capital is, and the market price

ought to be, vastly more than six per cent being always in the exact compound proportion of the demand and risk.

We think that the law is wrong in imposing any restraint upon the absolute freedom of commercial transactions, — which in order to be successful must be left unfettered. In the case of money, which represents every other commodity, the evil is far greater than it could be in the case of any other article of traffic. We know that in former ages, when the laws by a mistaken policy, forbade the receiving of any interest, condemning it as morally wrong, commerce and the arts were almost completely destroyed; and that as the opinion of mankind changed on this subject, and the laws became more liberal, commerce revived and extended its transactions, and scattered wider and wider its blessings. And we are firmly persuaded that neither this nor any other department of human industry will attain its perfection, until men of business are as unrestrained in buying and selling the media of exchange, as in buying and selling any other merchandise whatsoever.

We are also of opinion that while the present restrictions were intended to favor the interests of borrowers, they are even more injurious to borrowers than to lenders. But before demonstrating this proposition we beg leave respectfully to express our convictions that any attempt of the law to favor one particular class of citizens to the injury of any other class, is unjust, unconstitutional, and contrary to the spirit of freedom and equal rights; and although in this case the attempt is wholly unsuccessful, yet we cannot regard it, on that account, as less contrary to sound principles; and, both as borrowers and as lenders, we are equally hostile to the laws which sustain the attempt.

We will now endeavor to show that, in their practical effect, these laws are injurious to borrowers of money. Whenever the demand for money is such in the market as to render it worth more than the established rate of interest, the borrower, however pressing his want, however strong his necessity, cannot raise the requisite loan; for the money owner is not compelled to part with his money at less than its worth; and he will not be so foolish as to lend when he can find more profitable modes of investment; — and the borrower, although willing to pay any premium for relief, must suffer all the pressure of his emergency without the possibility of obtaining assistance. Cases of this sort we have all experienced and observed very frequently; and we know them to form the most serious obstructions to successful enterprise. So also we are aware that many instances occur in which the personal character of the borrower is such as to render the owner of money reluctant to venture on his credit at the usual rate; — while, did the law allow, the applicant would be glad to pay a premium pro-

portioned to the risk. In this manner, borrowers experience a compound evil, being unable to pay for the desired article according to its market value or their own necessities; and many a man is ruined who, if he could have been allowed to offer seven or eight, or more per cent. would have realized a fortune. Can any reason be assigned why the privilege of charging interest proportioned to the risk, allowed on bottomry loans should not be extended to every other species of loan?

The inconvenience experienced by money lenders, under the laws, though great, is yet less than that felt by borrowers, although these laws were intended for the borrowers' advantage. For, if the holders of money cannot lend at an interest equivalent to the value of the capital, they can invest that capital in those more profitable modes of traffic which create the money demand. Thus to them only one avenue of business is closed, while to the borrower, every resource is cut off. But it is certainly worthy of legislative attention that, even in a single particular, the process of business is impeded; and legislators, as such, in our opinion, are to be held responsible for the losses that the community may suffer in the person of its citizens, from this impediment.

The law is manifestly wrong in supposing that, if left unrestricted, money lenders would acquire an overgrown influence and exercise an oppressive power. Nothing of this sort can be reasonably feared, while we have such a host of banks and other monied corporations in addition to individual lenders, all in the market, and all engaged in active competition. No inconvenience of this kind is ever complained of in the case of bottomry loans, where the lenders are not restricted by any statute. No evil is found to exist in the matter of insurance premiums, where the risk is uniformly the measure of the rate. Competition, as much in the pecuniary facilities required by business men, as in the facilities of travel by land and sea, determines the price of those facilities. And is there not as much probability that the public will be burdened with exorbitant stage and steamboat fares, as with extortionous charges for the use of money? We are firm in the opinion that all money transactions should be regulated, like those in other articles of trade, only by this spirit of competition; and that no greater evils would or could, in the present age arise from the traffic in money being thus unrestricted, than are now felt from the perfect freedom allowed to traffic in other commodities. And it passes our understanding to see why that, whether money or goods, which is made the instrument of profit to him who uses it, should not in all cases, be sold at its real value.

The evils that grow out of our laws are enhanced by the fact that the rate of interest in a neighboring state is one per cent per

annum higher than in Massachusetts. In consequence of this difference, by which a constant drain is produced from our market, a vast amount of capital, which, if they were fettered by no law, would remain in circulation amongst our fellow citizens, is drawn into the New York market, and totally lost to our borrowers whose embarrassments are thereby increased. This evil is constantly and severely felt. But at particular times as in the present pressure on the money market, its burden is especially heavy and causes the greatest distress, particularly to those who are least able to sustain it, viz. business young men whose capital is small and of whom credit is the support. Were the present laws repealed, our own capital would remain in our own use, and the capital of the neighboring states would flow in upon us in such a manner that our business would be greatly extended and increased.

We would respectfully direct the attention of the Legislature to the numerous modes that have been devised for evading the laws; modes of transacting business, which, besides being circuitous and inconvenient, and besides taking away the sanction and protection of the law from those who engage in them, leaving no security but what is termed honor, thus increasing the risk, and of course the premium paid — besides these evils, which are loss of time, money, comfort and security — produce a fearful disregard of the laws, and establish a precedent of the utmost danger, while they tend to throw pecuniary negotiations in the hands of unprincipled and dangerous men. We need not specify the various methods by which the law is now evaded, and by which interest above six per cent is taken, in defiance of law, under the various names of "premium," "exchange," and "commission"; for these are matters of notoriety, and need only be alluded to in order to secure the attention of the Legislature. So long as our laws remain unchanged, it is vain to hope for a better state of things.

Such being the opinion of your petitioners they respectfully pray that the Usury Laws may be so modified as to leave the rate of interest, like the rate of premiums on insurances, perfectly open to contract, — providing, however, that in all cases where interest accrues, and the particular rate has not been expressly agreed upon between the parties, the present shall remain the legal rate.

And your petitioners will ever pray, &c.

(Signed by 202 business men of Boston, the first name being that of Wm. Tuckerman.)

REPORT OF THE COMMITTEE

In Senate, March 19, 1834

The Joint Select Committee, to whom was referred the petition

of William Tuckerman and others, for a repeal of the Usury Laws, have considered the same, and respectfully

REPORT

That the petitioners, a large number of the most intelligent and respectable citizens of Boston, set forth in a concise, but distinct form, two principal reasons why the Usury Laws ought to be repealed. The first is, that they are, in themselves, inexpedient and impolitic: the second, that they cannot be carried into effect; and by occasioning shifts and evasion of a more or less fraudulent character, create a great positive evil.

1. The value of money like that of every other article, naturally regulates itself. If the rate of interest upon it, as fixed by law, coincides with the real market value, the law has no operation whatever. If, on the other hand, the rate of interest, as fixed by law, be lower than the market value of money, then the effect of the law is to check the circulation of money, and thus impede and embarrass the natural course of trade. Thus in the only case in which it can operate at all, the operation of the law is directly injurious.

2. Were it even admitted that Usury Laws are, in themselves, expedient, experience shows that they cannot be carried into effect. The most general and pointed provisions that can be devised are easily eluded by slight changes in the form of the transaction, and the law is accordingly, in practice, constantly evaded. But such evasions are, when strictly considered, of a fraudulent character, and tend to diminish the respect that ought to be entertained by the community for the laws under which they live.

Such are the principal reasons that are urged by the petitioners as motives for the repeal of the Usury Laws. The Committee have no hesitation in saying that they entirely concur in these views of the subject. They might easily be sustained by strong arguments, and names of the highest authority, but at this late period of session the Committee have thought it inexpedient to submit a long report. It is believed that the general considerations connected with the question, are familiar to the public mind, and would gain nothing in form by being recapitulated in detail upon the present occasion.

These considerations apply equally to every branch of this subject, and would lead to a total repeal of the Laws against Usury. Believing however, that any sudden and extensive changes in the laws, are generally inexpedient, the Committee have preferred to recommend, at present, a repeal of the Usury Laws only so far as they apply to Promissory Notes and Bills of Exchange, payable not less than —— months after date, and during the time for which they were originally made payable. The evils of the existing sys-

tem are felt more strongly in reference to this class of contracts, than to any other, and it is therefore with them, that it appears expedient to begin the reform. The Committee accordingly report a Bill to that effect.

Which is respectfully submitted.

For the Committee

A. H. EVERETT

APPENDIX D

EXTRACT FROM A REPORT OF THE JOINT SELECT COMMITTEE UPON THE INTEREST LAWS WITH ACCOMPANYING DOCUMENTS, TO BOTH HOUSES OF THE GENERAL ASSEMBLY OF TENNESSEE, DECEMBER 17, 1859

The committee appointed under a resolution of the Legislature, "to investigate the present effect of the Usury Laws of Tennessee; to ascertain the amount of money used in shaving; the amount of domestic capital taken from the state to be used elsewhere and the average per cent paid by borrowers for the use of money in this state, and to report such other facts as might be pertinent to the subject matter of said resolution," have had the same under consideration, and have instructed the undersigned, as Chairman, to present a report upon all the facts which they have been enabled to elicit, and which he herewith submits to the consideration of your honorable body.

In the early part of the session the Committee addressed letters of inquiry to leading business men in the different counties of Tennessee, as well as to such persons residing in the states of Missouri, Mississippi and Louisiana, with a view of ascertaining, in the first instance, as far as possible, the practical operation of our own laws upon the subject of interest, and also, of the laws of the states named, where a different standard of value for the use of money has been established. In many cases these inquiries have not been answered; in others, the facts sought for have not been so fully stated as was desired, but many of the answers furnish important facts for the consideration of the legislature, and a portion of the letters containing them are appended as a part of this report, furnishing as they do, the basis upon which mainly rests its statements and conclusions. It will be seen by reference thereto, that comparatively but little money is now loaned out in Tennessee, at legal rates. In some portions of East and middle Tennessee, and occasionally by a conscientious guardian or private individual in other parts of the state, loans may be effected at the legal rate, but in these instances it is generally done more for accommodation to friends of known punctuality than for the sake of gain and in such amounts as cannot affect the truth of the proposition, that the rate of interest in Tennessee is largely over that which is estab-

lished by law and that the law fixing that rate for borrowed money, is no longer operative in keeping down the price of money, as demanded and regulated by the laws of trade and the wants of the community, whilst the same law is all efficient in aggravating the mischiefs which it was honestly intended to guard against.

It is impossible to ascertain the exact amount of money used in Tennessee in note shaving transactions. The law . . . like most other enactments guarded by heavy penalties and unjust discriminations, has defeated its own object. The note shaver fails to comply with the requirements and makes his customers pay for the risk he encounters, in depriving the treasury of what are its legitimate dues. Many of the wealthy counties have not paid a dollar into the treasury for the past year while their note shavers are carrying on profitable operations in almost every civil district — certainly in every incorporated village and town.

There is a large portion of capital in the hands of law abiding men who believe it a duty not to violate the laws of the land — men who are neither willing to burden their consciences with such an act, nor to incur the penalty of legal enactments. The legal rates of interest which the tax imposed upon money lenders, and the risk and expense incident to the loan of money, present no inducements to these men to make investments by way of loans; hence they very reasonably prefer to place their money on special deposit or to loan it in other states whose laws permit something like a fair remuneration for capital.

From the best information the committee has been able to obtain, there has been sent from the counties of Davidson, Shelby, Tipton, Decatur, Maury, Bedford and Montgomery about three million dollars, while from other counties large amounts have been sent off which have not been computed. This large amount has been banished from the state because of our unfortunate legislation that has arbitrarily fixed the price for the use of money at a standard below its actual value.

These capitalists thus driven from the field of competition employ agents in other states to loan their money at from eight to ten per cent where it can be legally done, but would, of course, prefer to have it under their immediate control, if permitted to do so, by a liberal system of legislation. . . .

R. G. Payne, *Chairman*

Dec. 17, 1859

APPENDIX E

ABSTRACT OF THE STATE INTEREST AND USURY LAWS OF THE UNITED STATES, 1921

NOTE. This Appendix and Chapter II were written as of 1921 because all the data in Chapter XII and Chapter XIII on actual rates charged in the United States are of 1921 or earlier. There are no later figures available on actual loan charges. The only value there is in studying usury laws in this connection, is to compare them with actual loan charges during the periods when the laws are in force. Changes are continually taking place in the usury laws. To ascertain what are the actual provisions to-day would necessitate a close study of the records of state legislatures. To make the abstracts and tables of this thesis conform approximately with present laws, the various state Revised Statutes should be consulted.

ALABAMA

Eight per cent is both the legal rate and the maximum limit for loans under contract. The lender forfeits all interest as a penalty for usury.

ALASKA

The legal rate of interest is eight per cent, but on contracts interest at the rate of twelve per cent may be charged by express agreement of the parties. The lender forfeits twice the excess as a penalty for usury.

ARIZONA

The legal rate is six per cent. The maximum lawful limit is ten per cent. The lender forfeits interest as a penalty for usury. By agreement in writing, interest may be compounded.

ARKANSAS

The legal rate is six per cent. This is the rate allowed where no rate has been agreed upon by the parties. Parties may agree verbally or in writing for ten per cent. Negotiable paper tainted with usury is void in the hands of an innocent holder. If contract for interest is in writing, it should read "until paid," as otherwise when merged in judgment it will bear only six per cent interest.

California

Seven per cent is the legal rate allowed where no rate is fixed by the parties. The maximum lawful limit is twelve per cent. The lender forfeits three times the excess interest as penalty for usury. Usury is also a misdemeanor punishable by fine and imprisonment. Fees, bonuses, commissions, etc., and all other evasions are particularly prohibited.

Colorado

The legal rate of interest on the forbearance or loan of any money and on claims, judgments, and accounts, in the absence of any express agreement between the parties is eight per cent per annum. The parties may stipulate in any bond, bill, promissory note, or other instrument in writing for the payment of a greater or higher rate of interest than eight per cent per annum and such stipulation may be enforced in any court of competent jurisdiction.

Connecticut

Any percentage by way of interest or discount may be reserved in writing. In the absence of a written contract made in the state, six per cent only is recoverable. On contracts made out of the state the legal rate of the state where made governs.

Delaware

The legal rate is six per cent. No higher than the legal rate can be agreed upon between parties. Penalty for usury is forfeiture of a sum equal to the amount loaned.

District of Columbia

The legal rate is six per cent. If any greater rate is stipulated the whole interest will be forfeited.

Florida

The legal rate is eight per cent. On special contracts any rate may be charged up to ten per cent. Penalty for usury is forfeiture of interest.

Georgia

The legal rate is seven per cent. Eight per cent is allowed on special contract in writing. Excess of interest forfeited on the plea of usury.

Open Accounts. "All accounts of merchants, tradesmen and mechanics which by custom become due at the end of the year, bear interest from that time upon the amount actually due whenever ascertained."

Hawaii

The legal rate is eight per cent. Lawful maximum, twelve per cent. Penalty for usury is imprisonment for not over one year or fine not over $250.

Idaho

The Idaho law goes into details. When there is no express contract in writing fixing a different rate of interest, interest is allowed at the rate of seven per cent per annum on: (1) money due by express contract; (2) money after the same becomes due; (3) money lent; (4) money due on a judgment of any competent tribunal or court; (5) money received to the use of another and retained beyond a reasonable time without the owner's consent, express or implied; (6) money due on a settlement of mutual accounts from the date the balance is ascertained; (7) money due on open accounts after three months from the date of the last item.

Parties may agree in writing to pay up to twelve per cent per annum.

Any judgment rendered on such contract would bear interest at the rate of seven per cent per annum. The penalty for a greater rate than above specified is as follows: When a greater rate than above specified has been contracted for, such contract works a forfeiture of ten cents on the dollar by the year on the amount of such contract to the school fund. The court must render judgment for said ten per cent in favor of the state for the school fund of the county, and the plaintiff is to have judgment for the principal sum less all payments of principal or interest theretofore made, and without interest or costs.

Illinois

Five per cent is allowed where no rate is specified. In all written contracts, parties may agree on any rate not exceeding seven per cent. On usurious contracts the entire interest is forfeited. Open accounts do not draw interest if disputed, unless delay of judgment is shown to be unreasonable and vexatious.

Indiana

The legal rate of interest is six per cent, but if a higher rate be contracted for in writing it can be recovered not exceeding eight per cent. If more than eight per cent is contracted for, but six per cent can be recovered. Where interest not exceeding eight per cent has been voluntarily paid, it cannot be recovered back. Interest on a closed account can be collected from the day an itemized bill is rendered and payment demanded.

Judgments cannot bear more than six per cent interest. Any one wishing to do business as a petty money-lender, which means the lending of money in sums of less than $250, may take out a license as a petty money-lender and may thereafter charge interest at the rate of two per cent a month in addition to the initial fee or commission of three dollars. The act does not apply to banks and trust companies, nor to loans over $250.

Iowa

Six per cent is the legal rate. Parties may agree in writing on any rate not exceeding eight per cent. If a rate of interest is contracted for greater than this, it works as a forfeiture of ten per cent on amount of the contract to the school fund, and the creditor can have judgment for the principal sum only without interest or costs.

Kansas

The regular legal rate is six per cent. Parties may agree in writing on any greater rate not exceeding ten per cent. If more than ten per cent be contracted for, the party forfeits double the sum in excess of that per cent.

Kentucky

The rate of interest is fixed at six per cent. This is also the lawful maximum. A contract for more is void. The lender may recover the amount actually loaned with lawful interest. The law does not allow interest on open accounts, unless specific agreement to pay the account at a definite time can be proved.

Louisiana

The legal rate is five per cent. Conventional interest expressed in writing may be as high as eight per cent. Debts bear legal rate of interest from maturity only unless otherwise stipulated. Compounding of interest is not lawful. The full face of a promissory note or other written obligation to pay money is recoverable, although it may include a greater rate of interest or discount than eight per cent per annum. It is a misdemeanor to lend or advance money at a greater rate of interest than eight per cent or a greater discount than twenty per cent per annum. This act does not apply to bond brokers, building and loan associations, or homestead associations authorized to do business in Louisiana, nor to banks, bankers, trust companies, or savings banks or to any transaction with banks, bankers, trust companies, or savings banks, or to loans made by manufacturers or merchants to their customers.

Maine

The legal rate is six per cent. There is no limit of the rate of interest which may be fixed by contract.

Maryland

The legal rate is six per cent. No higher rate is allowed. To take advantage of usury the debtor must tender the principal and legal interest. The contract is invalid only for the excess of interest charged or taken. Usurious interest once paid cannot be recovered after principal debt has been paid.

Massachusetts

Six per cent is the legal rate of interest when there is no agreement for a different rate. But any rate of interest may be received or contracted for, between the parties, provided, however, that no greater rate than six per cent can be recovered in any suit unless the agreement to pay the same is in writing, and provided also that all loans for less then $1000 may be discharged on payment of principal sum actually borrowed with interest at eighteen per cent and not exceeding five dollars for all expenses; but lender may have at least six months' interest at that rate if the loan is paid within that time. No bond of a corporation shall bear more than seven per cent.

Michigan

The legal rate is five per cent. Parties may agree in writing for any rate not exceeding seven per cent. If the contract sued on bears more than five per cent, then the judgment when rendered will bear the same rate as the contract or obligation sued upon. The penalty for taking usurious interest is a forfeiture of the entire interest.

Minnesota

The rate of interest unless a different rate is contracted for in writing is six per cent, and the highest rate that can be contracted for is ten per cent. A contract to pay interest not usurious upon interest overdue is valid. All contracts shall be at the same rate of interest after they become due as before, and any provision in a contract note or other instrument providing for an increase of the rate of interest upon maturity will work a forfeiture of the entire interest. Every person who for any loan or forbearance shall have paid or delivered any greater sum or value than the rate of interest allowed by law may recover from the person who has received the same or his personal representatives the full amount of interest so

paid. The action must be brought within two years. One half of the amount so recovered must be paid to the county treasurer for the use of the common schools.

All bonds, bills, notes, assurances, conveyances, chattel mortgages, and all other contracts and securities and all deposits or goods or anything whatever, whereupon or whereby there shall be reserved, secured or taken any greater sum or value for the loan or forbearance of any money, goods, or things in action than is allowed by law, is void except negotiable paper in the hands of a *bona-fide* purchaser for value without notice of the usurious transaction.

Mississippi

The legal rate is six per cent. Parties may agree in writing on any rate not exceeding eight per cent. If usurious interest be stipulated for, the effect is to forfeit all the interest and it may be recovered by the debtor or his representatives if paid. Local building and loan associations dealing alone with their own members in this state are not subject to usury laws.

Missouri

The legal rate of interest is six per cent. Parties may agree in writing upon any rate not exceeding eight per cent. Open accounts do not draw interest without proof of any express promise to pay interest. Accounts that are due draw interest from the date on which demand of payment is made. Usurious interest paid may be applied in payment of the principal debt and proof of the exaction of usurious rates of interest shall invalidate and render illegal any lien, mortgage, or pledge of personal property made to secure such indebtedness.

Montana

When no contract is made as to interest, the legal rate of eight per cent per annum governs after the debt is due. Parties may stipulate for any rate of interest not exceeding ten per cent per annum.

Nebraska

Seven per cent is the legal rate or any rate agreed upon not exceeding ten per cent on express contracts. If more is extracted the contract remains good as to principal, but all the interest is forfeited.

Nevada

Where there is no express contract in writing fixing a different rate of interest, interest shall be allowed at the rate of seven per

cent per annum for all moneys after they become due upon any bond, bill, or promissory note or other instrument in writing, or any judgment recovered before any court in this state for money lent, money due on settlement of accounts from the day on which the balance is ascertained (decided by supreme court — interest not allowed on open account) and for money received for the use of another. Parties may agree in writing for the payment of any rate of interest whatever upon money due or to become due on any contract. Judgments rendered upon contracts shall conform thereto and bear the interest agreed upon by the parties which shall be specified in the judgment: Provided only the amount of the original claim or demand shall draw interest after judgment. Interest cannot be made to compound even where it is so stipulated in written agreement. (So decided by the supreme court and never overruled.)

New Hampshire

The New Hampshire usury law was recently repealed by the legislature (1921) and the present law is intended to give all the provisions and advantages of the Massachusetts law. Legal rate six per cent. No limit. No penalty.

The Old Law: Interest was limited to six per cent unless a smaller rate was stipulated. The penalty for usury was forfeiture of three times the amount of illegal interest received to the party aggrieved, who should sue therefor. If the interest of a note was paid annually, the holder was entitled to recover simple interest on each year's interest from the time it was due until it was paid.

New Jersey

Six per cent is the legal rate. All contracts for a higher rate are void. If actions are brought to recover usurious debts, the creditor can recover only the actual amount loaned without interest or costs of suit, and any amount paid by way of interest shall be deducted from the amount actually loaned.

Mortgages on real estate are not usurious if they require payment of six per cent per annum and that the owner of the mortgaged property pay the taxes in addition to the interest.

New Mexico

Six per cent is the legal rate of interest, but parties may agree in writing for any rate of interest not exceeding twelve per cent. Open accounts bear interest at six per cent from six months after the date of the last item in the account. Judgments bear the same interest as contract sued on and, in absence of any specified rate, six per cent.

New York

Six per cent is the legal rate. All bonds, notes, contracts, securities, etc. (except bottomry and respondentia bonds), whereby a greater rate is reserved or taken or agreed for, are absolutely void. The lender upon a usurious rate can recover neither principal nor interest. But corporations cannot plead usury as a defense. Banks, private bankers, and individual bankers are not subject to the provisions of the general usury law. Under the banking law, banks and bankers taking, receiving, reserving, charging a greater rate of interest than six per cent shall forfeit the entire interest which the note, bill of exchange, or other evidence of debt carries with it or which has been agreed to be paid thereon. If a greater rate of interest has been paid, the person paying the same or his legal representatives may recover twice the entire amount of the interest thus paid from the bank or banker taking or receiving the same, if such action is brought within two years from the time the excess of interest is taken.

Usury is also a misdemeanor punishable by fine and imprisonment. In case of loans payable on demand for not less than $5000, for the repayment of which warehouse receipts, bills of lading, bonds, certificates of stock, bills of exchange, or other negotiable instruments are pledged as security, any rate of interest may be agreed upon in writing.

North Carolina

Six per cent is the legal rate. This is also the lawful maximum. If a usurious rate has been paid, double the amount may be recovered by action brought within two years. The only penalty for usurious interest is loss of the whole interest.

North Dakota

Interest for any legal indebtedness shall be at the rate of six per cent per annum unless a different rate is contracted for in writing and all contracts shall bear the same rate of interest after they become due as before unless it clearly appears therefrom that such was not the intention of the parties.

No person, firm, company, or corporation shall directly or indirectly take or receive, or agree to take or receive, in money, goods, or things in action, or in any other way, any greater sum or any greater value for the loan or forbearance of money, goods or things in action than (10) ten per cent per annum: and in computation of interest the same shall not be compounded. Any violation of this section shall be deemed usury: provided that any

contract to pay interest not usurious on interest overdue shall not be deemed usury.

Ohio

The legal rate is six per cent. Special contracts may be entered into stipulating for the payment of interest at any rate not exceeding eight per cent. Penalty for usury, forfeiture of the excess over six per cent.

Oklahoma

In absence of contract the legal rate is six per cent from maturity. May contract for as much as ten per cent. Judgments draw interest at six per cent per annum from date, except in case the contract upon which the judgment is based bears interest, in which case the judgment draws interest at the same rate not to exceed ten per cent. Usury forfeits all interest.

Oregon

The rate of interest in this state shall be six per cent per annum and no more and shall be payable in the following cases to wit: 1. On all moneys after the same becomes due; provided that open accounts shall bear interest from the date of the last item thereof. 2. On judgments and decrees for the payment of money from the date of the entry thereof unless some other date is specified in said judgment or decree. 3. On money received to the use of another and retained beyond a reasonable time without the owner's consent, expressed or implied. 4. On money due upon the settlement of matured accounts from the day the balance is ascertained. 5. On money due or to become due where there is a contract to pay interest and no rate is specified; Provided, however, that on contracts, interest up to the rate of ten per cent per annum may be charged by express agreement of the parties, and no more.

Pennsylvania

The legal rate is six per cent. A contract for a higher rate is void as to the excess over six per cent and such sum if paid may be recovered by suit brought within six months. A fair purchase of a bond or note may be made at any discount without being usurious.

Rhode Island

The legal rate of interest is six per cent when no rate is fixed upon by the parties. Any rate fixed by the contracting parties is legal except in the case of money loaned, in which case it is a criminal offense to charge interest in excess of thirty per cent on all amounts

exceeding fifty dollars and sixty per cent on all amounts under fifty dollars.

South Carolina

No greater rate of interest than seven per cent per annum can be charged upon any contract arising in the state except upon written contracts wherein by express agreement a rate of interest not exceeding eight (8) per cent may be charged. No person or corporation lending or advancing money or other commodity upon a greater rate of interest shall be allowed to recover in any court in this state any portion of the interest so unlawfully charged but may only recover the principal so lent or advanced without any interest and without costs.

Any person or corporation receiving a greater rate than eight (8) per cent shall not only forfeit the interest, but also double the sum received to be collected by a separate action or allowed as a counterclaim to any action brought to recover the principal.

Civil Code 1902, Sec. 1664, provides: that the borrower and his heirs, devisees, legatees, or personal representatives or any creditor or any person having a legal or equitable interest in the estate or assets of such borrower may plead the benefit of the provisions of this act as plaintiff or defendant and the same shall be effectual at any suit at law or in equity, and any person offending against the same shall be compelled to answer on oath any complaint that may be exhibited against him for the discovery of any sum of money or things in action so charged, agreed upon, reserved or taken, in violation of the foregoing provisions or either of them.

A.A. 1902 provides that no corporation shall by way of defense or otherwise avail itself of any of the foregoing provisions to avoid or defeat the payment of any interest which it has agreed upon, allowed, or contracted to pay, in any issue or sale of its coupon or registered bonds heretofore or hereafter made by it. Open accounts do not bear interest except on written agreement, except on claims against corporations. Judgments bear interest at seven per cent.

South Dakota

The legal rate is seven per cent, but persons may contract in writing for interest up to the rate of twelve per cent per annum. No person, firm, or corporation shall exact upon any loan (secured by any real estate mortgage for interest upon said loan and commissions for negotiating the same) a greater sum in the aggregate than ten per cent per annum upon the actual amount of money secured by such borrower upon such loan. Any person, firm, or corporation who shall exact of any borrower upon any loan (secured by mortgage of real estate) interest and commissions of any

sort or nature whatever a greater sum in the aggregate than ten per cent per annum upon the actual amount of money secured by such borrower upon any such loan, shall be deemed guilty of a misdemeanor and upon conviction shall be fined in any sum not exceeding five hundred ($500) dollars.

Tennessee

Six per cent is the legal rate of interest; any contract for a higher rate is usurious. Usury appearing on the face of an instrument renders it void altogether; otherwise the debtor can avoid only the excess over legal interest.

Texas

On written contracts ascertaining the sum payable, when no rate of interest is agreed upon, the legal rate is six per cent from the time when the sum is payable; parties to written contracts may stipulate for any rate of interest not exceeding ten per cent on the amount of the contract. Upon open accounts, when no specified rate of interest is agreed upon, interest is allowed at six per cent from the first day of January next after the accounts are made; judgments bear six per cent interest except where the judgment is founded upon a contract which bears a specified rate of interest greater than six per cent and not over ten per cent, in which case the judgment bears interest at the same rate as the contract. Written contracts which directly or indirectly stipulate for more than ten per cent interest are void for the whole amount of the interest, but the principal may be recovered. If usurious interest is paid the person paying the same may by an action brought within two years recover double the amount of the interest paid.

Utah

The legal rate of interest is eight per cent. Parties to any contract may agree in writing to any rate not to exceed twelve per cent per annum, provided that on loans of money only to the amount of one hundred dollars or less it may be agreed in writing to pay not to exceed one dollar for the first month, only, on said loan, but thereafter no greater rate than twelve per cent can be taken. All agreements to pay more than twelve per cent interest, with the above exception, are usurious and not enforcible. Principal and interest paid on a usurious contract may be recovered within one year after payment by the person making payment or his personal representative, and if not sued for, may within four years be recovered by the county superintendent of schools for the benefit of the school fund. Under laws of 1909 the taking of usury is a misdemeanor.

Vermont

Six per cent is the legal rate. Interest beyond that rate may be recovered back.

Virginia

The legal rate is six per cent. This is also the lawful maximum. The penalty for usury is forfeiture of all interest.

Washington

The legal rate is six per cent. The lawful limit is twelve per cent. The penalty for usury is forfeiture of amount of accrued interest, but if interest be paid, then forfeiture of twice the amount.

West Virginia

Six per cent is the legal rate. The debtor can avoid the excess over six per cent if he desires on contracts for more than the legal rate, except that corporations are not allowed to plead usury.

Wisconsin

Six per cent is the legal rate. Parties may agree in writing on any rate not exceeding ten per cent. Any usurious contract whereby more than ten per cent is agreed to be paid forfeits the whole interest, but leaves the principal debt collectible. Compound interest may be contracted for by written contract. There is also a right of recovery of treble amount of usurious interest which may have been paid.

Wyoming

The legal rate of interest, where there is no agreement between the parties, is eight per cent. Parties may stipulate for the payment of a higher rate of interest, but not exceeding twelve per cent. Unsettled accounts draw interest after thirty days from the date of the last item. If proof in any action shows a greater rate of interest has been contracted for, only the principal can be recovered and without costs.

APPENDIX F

THE ENGLISH MONEY-LENDERS' ACT, 1900

(63 and 64 Victoria, ch. 51)

Be it enacted by the Queen's Most Excellent Majesty, by and with the advice and consent of the Lords Spiritual and Temporal, and Commons, in this present Parliament assembled, and by the authority of the same, as follows:

1. (1) *Re-opening of transactions of money-lender.* Where proceedings are taken in any Court by a money-lender for the recovery of any money lent after the commencement of this Act, or the enforcement of any agreement or security made or taken after the commencement of this Act, in respect of money lent either before or after the commencement of this Act, and there is evidence which satisfies the Court that the interest charged in respect of the sum actually lent is excessive, or that the amounts charged for expenses, inquiries, fines, bonus, premium, renewals, or any other charges, are excessive, and that, in either case, the transaction is harsh and unconscionable, or is otherwise such that a Court of equity would give relief, the Court may re-open the transaction, and take an account between the money-lender and the person sued, and may, notwithstanding any statement or settlement of account or any agreement purporting to close previous dealings and create a new obligation, re-open any account already taken between them, and relieve the person sued from payment of any sum in excess of the sum adjudged by the Court to be fairly due in respect of such principal, interest and charges, as the Court, having regard to the risk and all the circumstances, may adjudge to be reasonable; and if any such excess has been paid, or allowed in account, by the debtor, may order the creditor to repay it; and may set aside, either wholly or in part, or revise, or alter any security given or agreement made in respect of money lent by the money-lender, and if the money-lender has parted with the security may order him to indemnify the borrower or other person sued.

(2) Any Court in which proceedings might be taken for the recovery of money lent by a money-lender shall have and may, at the instance of the borrower or surety or other person liable, exercise the like powers as may be exercised under this section, where proceedings are taken for the recovery of money lent, and the Court shall have power, notwithstanding any provision or agree-

ment to the contrary, to entertain any application under this Act by the borrower, or surety, or other person liable notwithstanding that the time for repayment of the loan, or any instalment thereof, may not have arrived.

(3) On the application relating to the admission or amount of a proof by a money-lender in any bankruptcy proceedings, the Court may exercise the like powers as may be exercised under this section when proceedings are taken for the recovery of money.

(4) The foregoing provisions of this section shall apply to any transaction which, whatever its form may be, is substantially one of money-lending by a money-lender.

(5) Nothing in the foregoing provisions of this section shall affect the rights of any *bona fide* assignee or holder for value without notice.

(6) Nothing in this section shall be construed as derogating from the existing powers or jurisdiction of any Court.

(7) In the application of this Act to Scotland this section shall be read as if the words "or is otherwise such that a Court of equity would give relief" were omitted therefrom.

2. (Registration of money-lenders, etc.)

3. (Regulations as to registration.)

4. (Penalties for false statements and representations.)

5. (Amendment of 55 and 56 Vict. c. 4, s. 2, as to presumption of knowledge of infancy.)

6. (Definition of money-lender.)

7. (Short title and commencement.)

APPENDIX G

CHIEF PROVISIONS OF THE USURIOUS LOANS ACT OF INDIA[1]

(Act No. X of 1918)

AN ACT TO GIVE ADDITIONAL POWERS TO COURTS TO DEAL IN CERTAIN CASES WITH USURIOUS LOANS OF MONEY OR IN KIND

Whereas it is expedient to give additional powers to courts to deal in certain cases with usurious loans of money or in kind; It is hereby enacted as follows:

I

SHORT TITLE AND EXTENT

1. This Act may be called the Usurious Loans Act, 1918.

2. It extends to the whole of British India, including British Baluchistan.

3. The Local Government may, by notification in the local official gazette, direct that it shall not apply to any area, class of persons, or class of transactions which it may specify in its notification.

II

DEFINITIONS

In this Act unless there is anything repugnant in the subject or context, —

1. "Interest" means rate of interest and includes the return to be made over and above what was actually lent, whether the same is charged or sought to be recovered specifically by way of interest or otherwise.

2. "Loan" means a loan whether of money or in kind and includes any transaction which is, in the opinion of the Court, in substance a loan.

3. "Suit to which this act applies" (defined).

[1] From D. F. Mulla, The Usurious Loans Act of 1918. (1918)

III

Re-opening of Transactions

1. Notwithstanding anything in the Usury Laws Repeal Act, 1855, where, in any suit to which this Act applies, whether heard *ex parte* or otherwise, the Court has reason to believe

(a) that the interest is excessive; and

(b) that the transaction was, as between the parties thereto, substantially unfair

the court may exercise all or any of the following powers namely, may —

(i) re-open the transaction, take an account between the parties, and relieve the debtor of all liability in respect of any excessive interest,

(ii) notwithstanding any agreement, purporting to close previous dealings and to create a new obligation, re-open any account already taken between them and relieve the debtor of all liability in respect to any excessive interest and if anything has been paid or allowed in account in respect of such liability, order the creditor to repay any sum which it considers to be repayable in respect thereof;

(iii) set aside either wholly or in part or revise or alter any security given or agreement made in respect of any loan, and if the creditor has parted with the security, order him to indemnify the debtor in such manner and to such extent as it may deem just:

Provided that, in the exercise of these powers, the Court shall not —

(i) re-open any agreement purporting to close previous dealings and to create a new obligation which has been entered into by the parties or any persons from whom they claim at a date more than six years from the date of the transaction;

(ii) do anything which affects any decree of a Court.

Explanation. — In the case of a suit brought on a series of transactions the expression "the transaction" means, for the purposes of proviso (i), the first of such transactions.

2. (a) In this section "excessive" means in excess of that which the Court deems to be reasonable having regard to the risk incurred as it appeared, or must be taken to have appeared, to the creditor at the date of the loan.

(b) In considering whether interest is excessive under this section, the Court shall take into account any amounts charged or paid, whether in money or in kind, for expenses, inquiries, fines, bonuses, premiums, renewals or any other

charges, and if compound interest is charged, the periods at which it is calculated, and the total advantage which may reasonably be taken to have been expected from the transaction.

(c) In considering the question of risk, the Court shall take into account the presence or absence of security and the value thereof, the financial condition of the debtor and the result of any previous transactions of the debtor, by way of loan, so far as the same were known, or must be taken to have been known, to the creditor.

(d) In considering whether a transaction was substantially unfair, the Court shall take into account all circumstances materially affecting the relations of the parties at the time of the loan or tending to show that the transaction was unfair, including the necessities or supposed necessities of the debtor at the time of the loan so far as the same were known, or must be taken to have been known to the creditor.

Explanation. — Interest may of itself be sufficient evidence that a transaction was substantially unfair.

3. This section shall apply to any suit, whatever its form may be, if such suit is substantially one for the recovery of a loan or for the enforcement of any agreement or security in respect of a loan.

4. Nothing in this section shall affect the rights of any transferee for value who satisfies the Court that the transfer to him was *bona fide*, and that he had at the time of such transfer no notice of any fact which would have entitled the debtor as against the lender to relief under this section. (Notice defined.)

5. Nothing in this section shall be construed as derogating from the existing powers or jurisdiction of any Court.

IV

Insolvency Proceedings

On any application relative to the admission or amount of a proof of a loan in any insolvency proceedings, the Court may exercise the like powers as may be exercised under section III by a Court in a suit to which this act applies.

APPENDIX H

THE UNIFORM SMALL-LOAN LAW

THIS law was drafted by the Division of Remedial Loans, Russell Sage Foundation, New York, an endowed philanthropy, after a thorough study of the small loan business and an extended survey of experimental legislation in many states, and it is believed to approximate a model small loan law. It is not expected that it will be enacted in all states without change. Local conditions and legislative customs may necessitate some minor amendments, but in all its essential features — license, supervision, interest rate, prohibition, penalties, etc. — the law should be adopted without amendment. With only slight variations, the law has been enacted in Maine, Illinois, Indiana, Connecticut, Georgia, Iowa, Arizona, Maryland, Rhode Island, and in amended form in Colorado, Michigan, New Hampshire, Virginia. Laws based upon the same theory as to supervision rates, regulation and necessary powers, are now in effect in Massachusetts, New Jersey, New York, Pennsylvania, Ohio, Oregon, Utah, and several other states, and in the main are working satisfactorily. The constitutionality of Ohio, Illinois, Pennsylvania, Georgia and Colorado laws have been sustained by the Supreme Courts of those states.

GENERAL FORM OF UNIFORM SMALL-LOAN LAW

(As Revised November 22, 1923.)

(Latest revisions printed in heavy type)

AN ACT to license and regulate the business of making loans in sums of three hundred dollars ($300) or less, secured or unsecured, at a greater rate of interest than . . . (legal contract rate) . . . per centum per annum, prescribing the rate of interest and charge therefor, and penalties for the violation thereof, and regulating the assignment of wages or salaries, earned or to be earned, when given as security for any such loan.

SECTION 1. *License.* . . . (Be it enacted, etc., or other appropriate enacting clause) . . . That no person, co-partnership, or corporation shall engage in the business of making loans of money, credit, goods, or things in action in the amount, or to the value of three hundred dollars ($300), or less, and charge, contract for, or receive a greater rate of interest than . . . (legal contract rate) . . . per

centum per annum therefor, except as authorized by this act and without first obtaining a license from the . . . (state officer in charge of banks) . . . hereinafter called the licensing official.

SECTION 2. *Application and fee.* Application for such license shall be in writing and shall contain the full name and address, both of the residence and place of business, of the applicant, and if the applicant is a copartnership, of every member thereof, or if a corporation, of each officer thereof; also the county and municipality, with street and number, if any, where the business is to be conducted. Every such applicant at the time of making such application, shall pay to the licensing official the sum of one hundred dollars ($100) as an annual license fee and in full payment of all expenses of examinations under, and administration of this act; provided that if the license is issued for a period of less than twelve months the license fee shall be pro rated according to the number of months that said license shall run.

SECTION 3. *Bond.* The applicant shall also, at the same time, file with the licensing official a bond in which the applicant shall be the obligor, in the sum of one thousand dollars ($1000) with one or more sureties (whose liability as such sureties, in the aggregate, shall not exceed $1000) to be approved by the licensing official, which bond shall run to the state of.....for the use of the state or any person, or persons who may have cause of action against the obligor of said bond under the provisions of this act. Such bond shall be conditioned that said obligor will conform to and abide by each and every provision of this act and will pay to the state and to any such person or persons, any and all moneys that may become due or owing to the state and to such person, or persons, from said obligor, under and by virtue of the provisions of this act.

SECTION 4. *License to issue.* Upon the filing of such application and the approval of said bond and the payment of said fee, the licensing official shall issue a license to the applicant to make loans in accordance with the provisions of this act for a period which shall expire.....day of.....next following the date of its issuance. Such license shall not be assignable.

SECTION 5. *Additional bond.* If in the opinion of the licensing official the bond shall at any time appear to be insecure, or exhausted, or otherwise doubtful, an additional bond in the sum of not more than one thousand dollars ($1000) satisfactory to the licensing official shall be filed within ten (10) days after notice to the licensee and upon failure of the obligor to file such additional bond, the license shall be revoked by the licensing official.

SECTION 6. *Revoking license.* The licensing official may, upon notice to the licensee and reasonable opportunity to be heard, re-

voke such license if the licensee has violated any provision of this Act; and in case the licensee shall be convicted by a court a second time of a violation of Section Thirteen (13) of this act the licensing official shall revoke such license; provided that the second offense shall have occurred after a prior conviction, in which case another license shall not be issued to such licensee, nor to the husband or wife of the licensee, nor to any co-partnership or corporation of which he is a member or officer.

SECTION 7. *Posting.* The license shall be kept conspicuously posted in the place of business of the licensee.

SECTION 8. *Name, place of business, etc.* No person, co-partnership, or corporation so licensed shall make any loan provided for by this act, under any other name, or at any other place of business, than that named in the license. Not more than one place of business shall be maintained under the same license, but the licensing official shall issue more than one license to the same licensee upon the payment of an additional license fee and the filing of an additional bond for each license.

SECTION 9. *Removal.* Whenever the licensee shall change his place of business, he shall at once give written notice thereof to the licensing official, who shall attach to the license his approval in writing of the change.

SECTION 10. *Examinations.* The licensing official for the purpose of discovering violations of this act, may either personally, or by any person designated by him, at any time and as often as he may desire, investigate the loans and business of every licensee and of every person, co-partnership, and corporation by whom, or which any such loan shall be made, whether such person, co-partnership, or corporation shall act, or claim to act as principal, agent, or broker, or under, or without the authority of this act; and for that purpose he shall have free access to the office or place of business, books, papers, records, safes and vaults of all such persons, co-partnerships, and corporations; he shall also have authority to examine, under oath, all persons whomsoever, whose testimony he may require, relative to such loans, or business.

SECTION 11. *Books and records.* The licensee shall keep such books and records in his place of business as in the opinion of the licensing official will enable the licensing official to determine whether the provisions of this act are being observed. Every such licensee shall preserve the records of final entry used in such business, including cards used in the card system, if any, for a period of at least two years after the making of any loan recorded therein.

SECTION 12. *Misleading advertisements.* No licensee, or other person, co-partnership, or corporation, shall print, publish, or distribute, or cause to be printed, published, or distributed in any

manner whatsoever, any written, or printed statement with regard to rates, terms or conditions for the lending of money, credit, goods, or things in action, in amounts of three hundred dollars ($300) or less, which is false, or calculated to deceive.

SECTION 13. *Rate of interest.* Every person, co-partnership, and corporation licensed hereunder may loan any sum of money not exceeding in amount the sum of three hundred dollars ($300) and may charge, contract for and receive thereon interest at a rate not to exceed three and one-half (3½) per centum per month.

Interest shall not be payable in advance, or compounded and shall be computed on unpaid balances. In addition to the interest herein provided for, no further or other charge, or amount whatsoever for any examination, service, brokerage, commission, or other thing, or otherwise, shall be directly, or indirectly charged, contracted for, or received, except the lawful fees, if any, actually and necessarily paid out by the licensee to any public officer, for filing, or recording in any public office, any instrument securing the loan, which fees may be collected when the loan is made, or at any time thereafter.

If interest, or charges in excess of those permitted by this act shall be charged, contracted for, or received, the contract of loan shall be void and the licensee shall have no right to collect, or receive any principal, interest, or charges whatsoever.

No person shall owe any licensee, as such at any time more than three hundred dollars ($300) for principal.

SECTION 14. *Requirements on making and payment of loans.* Every licensee shall: Deliver to the borrower, at the time the loan is made, a statement in the English language showing in clear and distinct terms the amount and date of the loan and of its maturity, the nature of the security, if any, for the loan, the name and address of the borrower and of the licensee and the rate of interest charged. Upon such statement there shall be printed in English a copy of Section Thirteen (13) of this act;

Give the borrower a plain and complete receipt for all payments made on account of any such loan at the time such payments are made; **permit payment of a loan in whole or in part prior to its maturity with interest on such payment to the date thereof.**

Upon repayment of the loan in full, mark indelibly every paper signed by the borrower with the word "paid" or "cancelled," and release any mortgage, restore any pledge, cancel and return any note and cancel and return any assignment given by the borrower as security.

SECTION 15. *No confessions, powers, etc.* No licensee shall take any confession of judgment, or any power of attorney. Nor shall he take any note, promise to pay, or security that does not state the

actual amount of the loan, the time for which it is made and the rate of interest charged, nor any instrument in which the blanks are left to be filled after execution.

SECTION 15a. **The payment of three hundred dollars ($300) or less in money, credit, goods or things in action, as a consideration for any sale, or other assignment of wages, salary, commissions or other compensation for services, whether earned or to be earned, shall be deemed a loan secured by such assignment, and the amount by which such assigned compensation exceeds such payment shall be deemed interest upon such loan from the date of such payment to the date such compensation is payable. Such loan and such assignment shall be governed by and subject to the provisions of this act.**

SECTION 16. *Wage assignments.* No assignment of or order for the payment of any salary, wages, commissions or other compensation for services, earned or to be earned, given to secure any such loan shall be valid unless such loan is contracted simultaneously with its execution; nor shall any such assignment, or order, or any chattel mortgage or other lien on household furniture then in the possession and use of the borrower be valid unless in writing signed in person by the borrower nor if the borrower is married, unless signed in person by both husband and wife; provided that written assent of a spouse shall not be required when husband and wife have been living separate and apart for a period of at least five months prior to such assignment, order, mortgage, or lien.

Under any such assignment or order for the payment of future salary, wages, commissions, or other compensation for services, given as security for a loan made under this act, a sum equal to ten (10) per centum of the borrower's salary, wages, commissions or other compensation for services shall be collectible therefrom by the licensee at the time of each payment of salary, wages, commissions or other compensation for services from the time that a copy of such assignment, verified by the oath of the licensee, or his agent, together with a certified statement of the amount unpaid upon such loan, is served upon the employer.

SECTION 17. *Prohibitions.* No person, co-partnership, or corporation, except as authorized by this act shall, directly, or indirectly, charge, contract for, or receive any interest, or consideration greater than . . . (the legal contract rate) . . . per centum per annum upon the loan, use, or forbearance of money, goods, or things in action, or upon the loan, use, or sale of credit, of the amount, or value of three hundred dollars ($300) or less.

The foregoing prohibition shall apply to any person who, as security for any such loan, use or forbearance of money, goods or things in action or for any such loan, use or sale of credit, makes a

pretended purchase of property from any person and permits the owner or pledgor to retain possession thereof, or who, by any device or pretense or charging for his services, or otherwise, seeks to obtain a greater compensation than is authorized by this act.

No loan for which a greater rate of interest or charge than is allowed by this act has been contracted for or received, wherever made, shall be enforced in this state, and any person in any wise participating therein in this state shall be subject to the provisions of this act.

SECTION 18. *Penalties.* Any person, co-partnership, or corporation and the several officers and employees thereof who shall violate any of the provisions of Sections One (1), Eight (8), Twelve (12), Thirteen (13), Fifteen (15), or Seventeen (17) of this act shall be guilty of a misdemeanor, and upon conviction thereof shall be punished by a fine of not more than five hundred dollars ($500), or by imprisonment of not more than six (6) months, or by both such fine and imprisonment, in the discretion of the court.

SECTION 19. *Excepted lenders.* This act shall not apply to any person, co-partnership, or corporation doing business under any law of this state, or of the United States relating to banks, trust companies, building and loan associations, or licensed pawnbrokers.

SECTION 20. All acts and parts of acts inconsistent with the provisions of this act are hereby repealed.

CODE NUMBERS OF SMALL-LOAN LAWS

The following states operate under the Uniform Law:

ARIZONA	Chapter 91, Laws of 1919.
CONNECTICUT	Chapter 219, Laws of 1919.
GEORGIA	Article 741, Laws of 1920.
ILLINOIS	Chapter 74, Secs. 14–20, Hurd's Rev. Statutes, 1917.
INDIANA	Chapter 125, Laws of 1917.
IOWA	House File 436, Laws of 1921.
MAINE	Chapter 298, Laws of 1917.
MARYLAND	Chapter 88, Laws of 1918.
PENNSYLVANIA	No. 1012, Public Laws of 1915, as amended 1919.
RHODE ISLAND	Chapter 2312, Public Laws of 1923.
VIRGINIA	Chapter 300, Laws of 1922.

The following states operate under laws which are the same in principle as the Uniform Law, but with a different rate:

COLORADO	Senate Bill 356, Laws of 1919.
MASSACHUSETTS	Chapter 727, Laws of 1911, as amended.

MICHIGAN	Act No. 317, Laws of 1921.
NEW HAMPSHIRE	Chapter 228, Laws of 1917.
NEW JERSEY	Chapter 49, Laws of 1914.
NEW YORK	Article 9 of the Banking Law (Chapter 2 of the Consolidated Laws).
OHIO	Laws of 1915, p. 281.
OREGON	Chapter 219, Laws of 1915.
UTAH	Chapter 41, Laws of 1917.

State	Year Enacted	Amount of License	Cost of Examination	Amount Bond	Supervision
Arizona	1919	$50	Included in license fee	$1,000	State Bank Comptroller
California	1918	None	None	None	None
Colorado	1919	$50	Included in license fee	$1,000	State Bank Commissioner
Connecticut	1919	$100 per annum	Included in license fee	$1,000	Bank Commissioner
Dist. of Columbia	1913	$1,000 per annum		$5,000	Supt. of Licenses
Georgia	1920	$100 per annum	Included in license fee	$1,000	State Bank Examiner
Illinois	1917	$50 per annum	Included in license fee	$1,000	Dept. of Trade and Commerce
Indiana	1917	$100 per annum	Included in license fee	$1,000	Dept. of Banking
Iowa	1921	$100 per annum	Included in license fee	$1,000	Supt. of Banking
Maine	1917	$50 per annum	Included in license fee	$1,000	State Bank Commissioner
Maryland	1918	$50 per annum	Included in license fee	$1,000	Bank Commissioner
Massachusetts	1916	$100 per annum		$5,000	Supervisor of Loan Agencies
Michigan	1921	$100 per annum	Included in license fee	$1,000	State Bank Commissioner
Mississippi	1914	$2,000 per annum[a]		$500	License Clerk in cities; else where by sheriff of county
Missouri	1913			$2,000	City Treasurer, unless othe wise designated by city ord nance
New Hampshire	1917	$50 per annum	Included in license fee	$1,000	Board of Bank Commissioners
New Jersey	1914	$50 per annum		$5,000	State Commissioner of Bankin and Insurance
New York	1920	None required		[b]$3,000	State Supt. of Banks
Ohio	1915	$100 per annum	Included in license fee	$2,000	Commissioner of Securities
Oregon	1915	$100 per annum		$1,000	State Supt. of Banks
Pennsylvania	1919	$50 per annum	About $10 per annum	$5,000	Secretary of Banking
Rhode Island	1923	$100 per annum	Included in license fee	$1,000	Bank Commissioner
Texas	1915			$5,000	Filing bond with Clerk of th County operates as license t do business
Utah	1917	$50 per annum	Included in license fee	$2,000	Bank Commissioner
Virginia	1918	$50 per annum	Included in license fee	$1,000	Chief Bank Examiner, Stat Banking Division

[1] This table is taken from the *Year-Book of the American Industrial Lenders' Association* for Decembe Street, Harrisburg, Pennsylvania.

[a] City of Jackson levies license on all callings, trades, or professions of 50% of the state license.

Experience proves the best conditions exist in the states where the Uniform Small-Loan Law is in force ances, no fees, but statements and receipts and penalties for violation. Where the rate is lower there is no lower rate laws are frequently violated or evaded. The laws that provide lower rates and a fee are diff tained.

[c] 5% loans up to $1,000; 3% over $1,000.

[d] $1 on loans of $50 or less; $2 on loans over $50; based on loans for at least four months.

[e] $1 on $50 or less; $2 over $50, but not over $150; $3 over $150 to $300; no such charge shall be made after such charge; nor for loan to be repaid in less than one month; no fee on loan less than $10.

[h] $1 on $50 or less, for not less than four months; but shall not be charged again for at least four months.

E SMALL-LOAN LAWS[1]

INTEREST RATE	HOW COMPUTED	LAW GOVERNS PAWNBROKING	FEES	LIMIT	STATEMENT AND RECEIPT REQUIRED	PENALTIES FOR VIOLATION
% per month	On unpaid balances	.....	None	$300	Yes	Imprisonment and fine
per month	No provision	.....	[c]5%	None	None	Fines, $25 to $500. Imprisonment, six months to one year
per month	On unpaid balances	.....	[d]$1	$300	Yes	Loss of principal and interest, $300 fine, six months' imprisonment
% per month	On unpaid balances	.....	None	$300	Yes	Not more than $500 fine, or not more than six months' imprisonment, or both
per month	On unpaid balances	.....	None	$200	.....	Imprisonment and fine
% per month	On unpaid balances	.....	None	$300	Yes	Fine or imprisonment, or both
per month	On unpaid balances	.....	None	$300	Yes	Imprisonment and fine
per month	On unpaid balances	.....	None	$300	Yes	Imprisonment and fine
per month	On unpaid balances	.....	None	$300	Yes	Imprisonment and fine
per month	On unpaid balances	.....	None	$300	Yes	Imprisonment and fine
per month	On unpaid balances	.....	None	$300	Yes	Imprisonment and fine
nd 2% per month	On unpaid balances	.....	[e]$1	$300	Yes	Imprisonment and fine
per annum	.....	.....	None	None	.....	Imprisonment and fine
per month	On unpaid balances	.....	None	$300	.....	Imprisonment and fine
per month	On unpaid balances	Yes	[f]$1	$300	Yes	Imprisonment and fine
per month	On unpaid balances	.....	None	$300	Yes	Imprisonment and fine
er month	On unpaid balances	.....	[e]$1	$300	Yes	Imprisonment and fine
er month	On unpaid balances	.....	[b]$1	None	Yes	Fine $50 to $200 first offense; imprisonment for second offense and fine of $200 to $500
er month	On unpaid balances	Yes	None	$300	.....	Imprisonment and fine
per month	On unpaid balances	.....	None	$300	Yes	$50 to borrower; $500 fine; six months' imprisonment
per month	On unpaid balances	.....	None	$300	Yes	Imprisonment and fine
per annum	On unpaid balances	.....	.....	None	.....	No imprisonment; fine
er mo. or fraction	On unpaid balances	.....	None	$300	Yes	Imprisonment and fine
per month	On unpaid balances	.....	None	$300	.....	Imprisonment and fine

pp. 124–25. The figures were compiled by Mr. Geo. W. Kehr, Secretary of the Association, 204 Chestnut

[b] 10% of capital, but at least $3,000.

law provides, license, bond, state supervision and interest rate of 3½% per month computed on unpaid balnt capital and needy borrowers are without service. This law is easily administered and enforced, but the administer and usually are manipulated by the lenders so that a rate in excess of the "scientific" rate is ob-

[d] $1; not more than 4 times yearly.

[e] $1 on $50 or less; $2 from $51 to $300; not more than three fees to be charged in any year.

[f] note or renewal oftener than once in 12 months; no fee for new or additional loan made within three months

APPENDIX J

DRAFT OF PROPOSED UNIFORM PAWNBROKING BILL [1]

A Bill Entitled

AN ACT TO LICENSE PAWNBROKERS AND REGULATE THEIR BUSINESS AS SUCH

Be it enacted by the.....of the State of.....as follows [or other enacting clause]:

ARTICLE I

SHORT TITLE AND DEFINITIONS

SECTION 1. *Short Title.* This act shall be known as the "Pawnbroking Law."

SECTION 2. *Definitions.* In this act, unless the context otherwise requires:

"Pawnbroker" means any person, partnership, association or corporation (1) lending money on the deposit or pledge of personal property, other than choses in action, securities or printed evidences of indebtedness; or (2) purchasing personal property on condition of selling it back at a stipulated price; or (3) doing business as furniture storage warehouseman and lending money upon goods, wares or merchandise pledged or deposited as collateral security.

"Pledge" means an article or articles deposited with a pawnbroker in the course of his business as defined in the preceding paragraph.

"Pledger" means the person who delivers a pledge into the possession of a pawnbroker, unless such person discloses that he is or was acting for another; and in such event "pledger" means the disclosed principal.

ARTICLE II

LICENSING AND SUPERVISION OF PAWNBROKERS

SECTION 3. *License.* No person, partnership, association or corporation shall engage or continue in business as a pawnbroker except as authorized by this act and without first obtaining a license from the....., hereinafter called the licensing official.

[1] This proposed law is taken from the Bulletin of the National Federation of Remedial Loan Associations for September, 1923, pp. 65–71, and is sponsored by that organization. The Chairman is Mr. Arthur H. Ham, 346 Fourth Avenue, New York City.

SECTION 4. *Application.* Application for such license shall be in writing and shall state the full name and place of residence of the applicant, or, if the applicant be a partnership, of each member thereof, or, if a corporation or association, of each officer thereof, together with the place or places where the business is to be conducted.

SECTION 5. *License Fee.* If such application be approved by the licensing official he shall issue a license to the applicant upon payment of the license fee and the filing of a bond as hereinafter provided. Such license shall not be assignable. It shall run from the date of its issuance to the end of the calendar year, and shall be renewed each year thereafter. The fee for such license shall be One Hundred Dollars ($100) per annum, or a proportionate amount for a period of less than one year, for each place of business conducted by the licensee as such; which fee shall be in full payment of all expenses of examination under, and administration of, this act. *Provided, however,* that any pawnbroker who, at the time this act becomes effective, is duly licensed as a pawnbroker under the provisions of Chapter...., Laws of.....[any prior State Law] or under authority of any local ordinance or regulation, shall not be required to procure a license or furnish a bond under this act until the expiration of such existing license, but shall nevertheless be subject to all the other provisions of this act.

SECTION 6. *Disposition of License Fees.* All license fees received by the licensing official shall promptly be remitted to the State Treasurer, who shall apply the same to the payment of expenses incurred in the administration and enforcement of this act, upon vouchers approved by the licensing official.

SECTION 7. *License Bond.* The licensee shall file with the licensing official a bond in the sum of One Thousand Dollars ($1000.00), as principal, with one or more sureties to be approved by the licensing official. The aggregate liability of such sureties shall not exceed the amount stated in the bond. Such bond shall run to the State of .....for the use of the State and of any person or persons who may have a cause of action against the principal as licensee under the provisions of this act. The condition of such bond shall be, that the principal will comply with and abide by all the provisions of this act, and will pay to the State or to any person or persons any and all moneys that may become due to the State or to any person or persons from the said principal under and by virtue of the provisions of this act. A separate bond shall be required for each place of business, if more than one, conducted by such licensee. If, in the opinion of the licensing official, the bond shall at any time appear to be insecure or insufficient, he may require either an additional bond in the sum of not more than One Thousand Dollars

($1000.00), or the cancellation of the existing bond and the execution of a new one, in the same amount. If any person shall be aggrieved by the misconduct of a pawnbroker, and shall recover judgment against him therefor, such person may, after the return unsatisfied, either in whole or in part, of any execution issued upon said judgment, maintain an action in the name of the State for his own use upon the bond of the pawnbroker in any court having jurisdiction of the amount claimed, provided the licensing official assents thereto.

SECTION 8. *Revocation of License.* The licensing official may, upon notice to the licensee and reasonable opportunity to be heard, revoke such license for a violation by the licensee of any provision of this act, or of any regulation promulgated by the licensing official.

SECTION 9. *Posting License.* Such license shall be kept conspicuously posted in the licensee's place of business.

SECTION 10. *Removal.* Whenever the licensee shall change his place of business he shall at once give written notice thereof to the licensing official, who shall indicate on the license his approval in writing of the change of location.

SECTION 11. *Examinations.* The licensing official may at any time, and shall at least once a year, investigate the business of all licensees, either personally or by any person designated by him. For the purpose of such investigation the licensing official or the person designated to act for him shall have free access, during usual business hours, to the licensee's place of business and to the books, papers, records, safes and vaults of such licensee, wherever located within the state, and shall also have authority to examine, under oath, any person whose testimony he may require relative to such business.

SECTION 12. *Regulations.* Subject to the provisions of this act, the licensing official may prescribe the form of books and records to be kept by licensees, which shall be preserved for at least two years from the date of making the loan and be available to parties in interest. He may adopt and promulgate such other rules and regulations, not inconsistent with the provisions of this act, as he may deem necessary for the proper conduct of his office and the enforcement of this act. In the exercise of such power, he shall coöperate with the police or other officials of municipalities for the discovery or restoration of stolen property.

SECTION 13. *Annual Report.* Every pawnbroker shall, on or before the first day of February each year, submit to the licensing official in such form as may be prescribed by the latter, a report under oath, giving the number and amount of loans made during the preceding calendar year, the balance of loans outstanding at the close of the year, the maximum and minimum amounts loaned and rates of interest charged.

ARTICLE III

Pledge Contract and Record

Section 50. *Original Record.* Every pawnbroker shall keep a book in which shall be recorded, in ink, at the time of making each loan, the name and address of the pledger, or, where the pledge is made by a person acting as agent for a disclosed principal, the names and addresses of principal and agent; the date of the transaction; amount of the loan; the article or articles pledged; and the serial number of the loan. There shall also be recorded in such book the date on which each loan was cancelled, and whether it was redeemed or renewed or whether the collateral was sold at auction. In a separate book the licensee shall record in ink all sales of unredeemed pledges, showing the number, date, amount, and duration of each loan, the date of the sale, the amount realized from the sale of the collateral, the amount charged to the pledger as interest, commission and expenses of sale, the amount of the surplus or deficit, as the case may be, the date on which, and the person to whom, the surplus, if any, was paid. All entries herein provided for shall be made in the English language.

Section 51. *Signature of Pledger.* The pawnbroker shall at the time of making a loan require the pledger or his agent to write his signature and address on a card bearing the serial number of the loan corresponding to that recorded in the pawnbroker's book as provided in the last preceding section. If such person is unable to write he shall sign by mark, and in such event the pawnbroker shall record on the signature card such information as will enable him to identify the person in case of the loss of the ticket.

Section 52. *Pawn Ticket.* The pawnbroker shall at such time deliver to the pledger or his agent a memorandum or ticket on which shall be legibly written or printed the name of the pledger; the name of the pawnbroker and the place where the pledge is made; the article or articles pledged; the amount of the loan; the date of the transaction; the serial number of the loan, the rate of interest; and a copy of Sections 59 and 61 of this Article. A pawnbroker may insert in such ticket any other terms and conditions not inconsistent with the provisions of this act; *provided,* however, that nothing appearing on a pawn ticket shall relieve the pawnbroker of the obligation to exercise reasonable care in the safekeeping of articles pledged with him.

Section 53. *Negotiability of Ticket.* Except as otherwise herein provided, the holder of such ticket shall be presumed to be the person entitled to redeem the pledge; and the pawnbroker shall deliver the pledge to the person presenting the ticket, upon payment of principal and interest.

SECTION 54. *Redemption by Mail.* When a ticket, instead of being presented in person, is sent to the pawnbroker by mail, accompanied with a money order or bank draft for the amount due including the charges for shipment as desired, and twenty-five cents for packing, the pledge shall be securely packed and forwarded by the pawnbroker in accordance with the remitter's instructions, if any. If the remittance is insufficient to cover the amount due, the charges of shipment as desired, and packing, the pawnbroker shall either notify the remitter of the amount of the deficiency or send the pledge subject to the payment of shipping charges by the consignee. The pawnbroker's liability for the pledge shall cease upon delivery thereof to the carrier or his agent.

SECTION 55. *Payment of Installments.* Upon the presentation of the ticket and the tender of not less than five dollars as an installment on the principal, together with accrued interest, the pawnbroker shall accept the same and issue a new ticket for the reduced amount.

SECTION 56. *Loss of Ticket.* If such ticket be lost, destroyed, or stolen, the pledger shall so notify the pawnbroker in writing. The receipt of such notice shall be treated by the pawnbroker as a stop against the loan, and thereafter the provisions of the three last preceding sections shall not apply to such loan. Before delivering the collateral or issuing a new ticket, in such event, the pawnbroker shall require the pledger to make affidavit of the alleged loss, destruction or theft of the ticket. Upon receipt of such affidavit, the pawnbroker shall permit the pledger either to redeem the loan or to receive a new ticket upon the payment of accrued interest; and the pawnbroker shall incur no liability for so doing, unless he has previously received written notice of any adverse claim.

SECTION 57. *Altered Tickets.* The alteration of a ticket shall not excuse the pawnbroker who issued it from liability to deliver the pledge according to the terms of the ticket as originally issued, but shall relieve him of any other liability to the pledger or holder of the ticket.

SECTION 58. *Counterfeit Tickets.* If a ticket is presented to a pawnbroker which purports to be one issued by him, but which is found to be spurious, the pawnbroker may seize and retain the same without any liability whatsoever to the holder thereof. Any such ticket so seized shall be delivered to the licensing official.

SECTION 59. *Rates of Interest.* A pawnbroker shall not charge or receive interest on loans in excess of three per centum per month, computed exactly on unpaid balances; *provided*, however, that on loans redeemed within the first month he may charge a month's interest, and *provided, further*, that he may charge a minimum of fifteen cents where the interest herein allowed amounts to less. If a

pawnbroker charges or receives interest in excess of that herein provided, or makes any charges not authorized by this act, he shall forfeit principal and interest and shall return the pledge upon demand of the pledger and surrender of the pawn ticket, without tender of principal or interest. If such excessive or unauthorized charges have been paid by the pledger, he may recover the same, including the principal, if paid, in a civil action against the pawnbroker.

SECTION 60. *Care of the Pledge.* A pawnbroker shall be liable for the loss of a pledge or part thereof, or for injury thereto, whether caused by fire, theft, burglary, or otherwise, resulting from his failure to exercise reasonable care in regard to it; but he shall not be liable, in the absence of an express agreement to the contrary, for the loss of a pledge or part thereof, or for injury thereto, which could not have been avoided by the exercise of such care. The burden of proof to establish due care shall be upon the pawnbroker.

SECTION 61. *Sale of the Pledge.* All unredeemed pledges shall be sold at public auction, but not before the expiration of twelve months, nor later than the expiration of eighteen months, from the date of the loan, unless otherwise agreed in writing between the pawnbroker and the pledger, or authorized by the licensing official for due cause shown.

SECTION 62. *Notice of Sale.* No pledge shall be sold unless written or printed notice thereof has first been mailed to the last known address of the pledger at least twenty days prior to the date of sale. Notice of such sale shall also be published in three consecutive issues of a daily or weekly newspaper published in the city or county where the pawnbroker's business is conducted; such notice shall specify the time and place of the sale and the inclusive dates and numbers of the unredeemed loans, but shall not exceed fifty agate lines of space.

SECTION 63. *Disposition of Proceeds.* The proceeds of such sale shall be applied to the purposes, and in the order, here specified: Auctioneer's charges; principal and interest of the loan; and a proportionate share of the expense of publishing the notice of sale, determined by dividing the total expense of such publication by the number of loans sold. The surplus, if any, shall be paid to the pledger or any one else who would have been entitled to redeem the pledge if it had not been sold. Notice of such surplus, if any, shall be mailed to the last known address of the pledger.

SECTION 64. *Reversion of Surplus.* If a surplus be not paid or claimed within five years from the date on which it accrued, it shall revert to the pawnbroker for his own use and benefit. Interest on unpaid surplus at the rate of six per centum per annum shall accrue only after the pawnbroker's refusal to pay the same upon lawful demand therefor.

ARTICLE IV

Miscellaneous Provisions

Section 100. *Pawnbroker's Lien on Pledge.* A pawnbroker shall have a first lien on all pledges for the amount of his loan and interest in all cases except where the pledging or possession thereof by the pledger constituted larceny at the common law, or except where a prior lien exists by virtue of any other statute.

Section 101. *Ticket Must Be Surrendered or Impounded.* Except as otherwise provided in this act, a pawnbroker shall not be required, by legal process or otherwise, to deliver a pledge except upon surrender of the ticket, unless the ticket be impounded or its negotiation enjoined by a court of competent jurisdiction.

Section 102. *Adverse Claims.* If more than one person shall claim the right to redeem a pledge, the pawnbroker shall incur no liability for refusing to deliver the pledge until the respective rights of the claimants shall have been adjudicated. In case of an action brought against the pawnbroker for recovery of the pledge, he may as a defense require all known claimants to interplead. If no action be brought against the pawnbroker by either party within the period for which he is required under Section 61 hereof to hold the pledge, or within thirty days after notice of an adverse claim, he may proceed to sell the pledge and hold the surplus, if any, subject to adjudication or other adjustment of the parties' rights.

Section 103. *Prohibited Transactions.* A pawnbroker shall not:

1. Accept a pledge from any person who is under the age of sixteen years.

2. Transact any business on Sunday; nor between the hours of six o'clock in the evening and seven o'clock in the morning; provided, however, that on Saturday he may transact business up to the hour of ten o'clock P.M.

Section 104. *Penalties.* Any person, partnership, association or corporation who or which violates either Section 3, Section 59, Section 61 or Section 63 of this act, or commits any willful fraud in the course of his business, shall be guilty of a misdemeanor, punishable by a fine of not more than five hundred dollars ($500.00) or by imprisonment for not more than six months, or by both fine and imprisonment, in the discretion of the court.

Section 105. *Interpretation to Secure Uniformity.* This act shall be interpreted and construed so as to effectuate its general purpose to make uniform the law of those states which enact it.

Section 106. *Constitutionality.* If any section or provision of this act be decided by the courts to be unconstitutional or invalid, such adjudication shall not affect the validity of the act as a whole

or of any other portion thereof which can be given reasonable effect without the provision held to be unconstitutional or invalid.

SECTION 107. *Repealer.* Chapter .....of the Laws of ....., and all other acts or parts of acts inconsistent herewith, are hereby repealed.

SECTION 108. *Date effective.* This act shall take effect on and after the first day of ..... next following its passage and approval.

APPENDIX K

DIGEST OF PAWNBROKING LAWS IN THE UNITED STATES[1]

Name of State	Date of Law	Loan Charges
Arizona	1913	2% per month.
California	1909	2% per month.
Colorado	1897	3% per month.
Connecticut	1905	3% per month.
Delaware	1907	8% per month and 3% per month extra care.
Dist. Columbia	1921	1% per month.
Georgia	1908	5% per month and fees.
Illinois	1909	3% per month.
Indiana	1917	3% per month.
Iowa	1915	2% per month and fees.
Maine	1917	3% per month.
Maryland	1906	2% per month.
Massachusetts	1916	3% to 5% per month.
Michigan	1911	2% per month.
Missouri	1909	2% per month.
Montana	1903	3% per month.
Nebraska	1915	10% per year and fees.
New Hampshire	1917	3% per month.
New Jersey	1887	2% per month.
New Mexico	1866	10% per month.
New York	1909	$100 and less, 3% per month, first 6 mos.; 2% per month thereafter. Loans over $100, 2% per month, first 6 months, 1% per month thereafter.
Ohio	1915	3% per month and fees.
Oregon	1915	3% per month.
Pennsylvania	1856	¼% per month and 5% per month charges.
Rhode Island	1909	$50 and less, 5% per month for 3 months; 3% per month more than 3 months. More than $50, 3% per month.
Vermont	1913	5% per month.
Virginia	1903	10% per month, less than $26; 5% per month, $26 to $100; 3% per month, loans over $100.
Washington	1909	3% per month.
Wisconsin	1915	10% per annum and fees.

[1] This tabulation was prepared from data submitted in Senate Calendar 158, Report 145, 67th Congress, 1921.

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